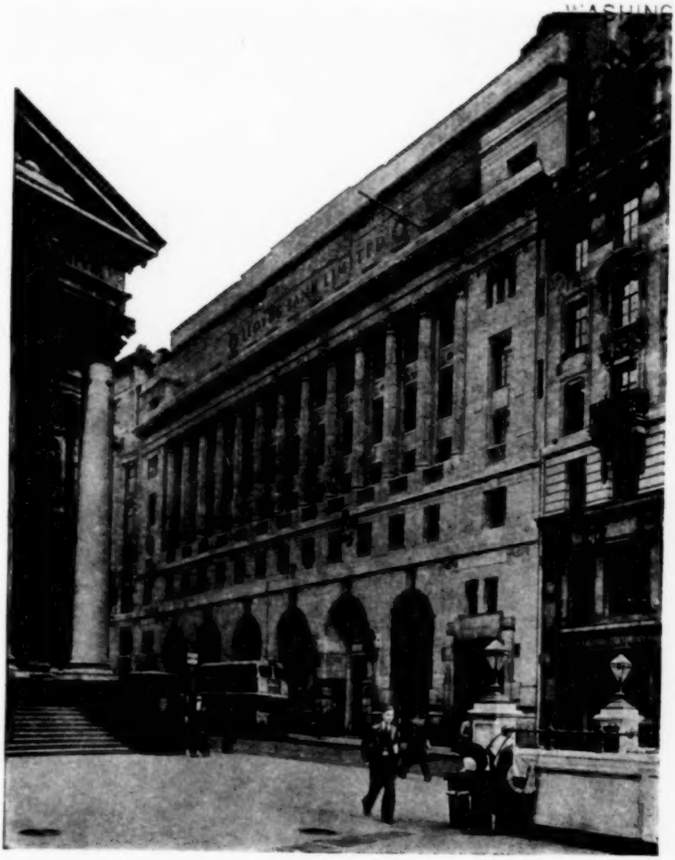

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The Bank publishes from time to time in this REVIEW *signed articles by exponents of different theories on questions of public interest. The Bank is not necessarily in agreement with the views expressed in these articles. They are published in order to stimulate free discussion and full inquiry.*

Controls: Financial v. Physical

*By The Rt. Hon. Lord Balfour of Burleigh, D.C.L., D.L.**

LAST November, as we all know, the present Government announced a number of important measures in the field of monetary policy. In some respects these reaffirmed and intensified policies followed for several years previously: for example, the new directives governing bank lending. But in other respects a complete break was made with the recent past, notably in the restoration of flexibility to Bank Rate and therefore to the whole complex of short-term interest rates.

The immediate short-run objective of the new monetary policies is, of course, to help in getting the balance of payments straight again, for these measures were taken at a time of appalling danger in our external payments, in the midst of a crisis that is still with us. About that aspect of the matter I have already said a great deal on other occasions. My present purpose is to emphasize the very great long-run advantages to our whole economic life, internal as well as external, that would result from the restoration of a healthy monetary position.

What we are witnessing, surely, is an attempt to root out inflation at the source by cutting down the surplus spending power that made inflation possible, the surplus spending power which has been the legacy first of the war and then of the cheap money drive. For years past, spending has been outrunning our capacity to produce, resulting in a constant upward pressure on wages and the cost of living, and hence a continuing fall in the value of our currency. Through the return to some degree of monetary discipline, we may hope to establish once again a proper relationship between spending power and productive capacity. And once that has been accomplished we can hope once again not only for over-all stability in the level of prices. Perhaps even more important, we shall have returned to a situation in which the price system can perform its proper and immensely valuable functions. It is the immense superiority of a properly working price system over the system of physical controls as the normal method of regulating our economic life

* An address delivered by Lord Balfour of Burleigh to the Rotary Club of London on June 11th was based on this paper.

that I want to stress. This is, I well know, a controversial subject but it will be realized that I am discussing it entirely as one who has some acquaintance with finance and not in any sense from the viewpoint of party politics.

First, let me define my terms. The price mechanism, on the one hand, and direct or physical controls, on the other hand, are the two fundamentally different methods of adjusting the demand for any good to the available supply. Under the price mechanism, supply and demand are brought into harmony by the movement of prices; the allocation of the available resources is determined by the operation of market forces. That may sound rather difficult and abstract. What it means in practice is the kind of situation we took for granted before the war, a situation in which every single consumer in the country could walk into any shop anywhere and buy (up to the limit of his money income, naturally) whatever he wanted. No matter what the commodity, he need produce no ration book before he could buy, nor be registered at a particular shop or tied in any other way to a particular source of supply. Such questions simply did not arise, for in those days there were no such things as "shortages", not because physical supplies were necessarily any greater but because prices were uncontrolled and so brought demand and supply into balance. Nowadays, of course, the very expression "uncontrolled" prices suggests exorbitant prices. In reality, as we all know, the free, uncontrolled prices of pre-war days were both low and stable by comparison with anything that has happened since. The situation, now so familiar, in which any price that is free to move tends to shoot upwards, is a product of inflation.

That is an indication of what I have in mind in speaking of the price system. Direct or physical controls, on the other hand, mean that rationing or allocation takes the place of the operations of a free market as a means of reducing demand to equality with the available supply. The essential feature of such methods is that resources are allocated in accordance with a decision taken centrally. Under war conditions, for example, we all accepted without question the rationing of basic foodstuffs as one means of ensuring that nobody should go without. But the range of commodities for which rationing can form even a tolerably efficient method of distribution is extremely limited. It is only at the level of the most simple and elementary wants that it is at all reasonable to take a centralized decision,

in Westminster or Whitehall, that " everybody is to have three ounces of tea " or " everybody is to have half a pound of sugar ".

As soon as one goes outside this narrow range, rationing is at once shown up for the primitive mechanism which it is. That is due partly to technical reasons, such as the fact that you cannot ration perishables like fish or vegetables. It is much more because in an advanced community our standard of living comprises an immense variety of things over and above mere subsistence, and in respect of these rationing cannot take account of individual tastes, preferences and circumstances. That can be done *only* by a properly functioning price system; for it is only under such a system that the decisions are made by the millions of individual consumers, deciding—in the light of prices on the one hand and their individual preferences on the other hand—how to spend to the best advantage such money as they have.

AUTHORITY v. THE INDIVIDUAL

It is true that the effective range of rationing can be extended somewhat by ingenious devices such as the " points " system adopted for sweets, and formerly for groceries and clothes. But with the points scheme you are already half-way back to the market mechanism, for the " points " are in effect a second form of money, an alternative currency to the real currency disrupted by the inflationary conditions of war finance. It is interesting, too, to note how rapidly a system of barter springs up for rationed commodities; one soon finds a packet of tea being swapped for half a pound of butter across the garden fence, or a market growing up in clothing coupons. This, of course, is anathema to those who want to ration us and is usually made illegal; yet in fact it simply indicates how the great variety of individual tastes and preferences, even in respect of basic wants, will find means of satisfying themselves.

In every rationing scheme there is an element of Whitehall saying " We know best what you want "; the emergence of barter or a market in coupons is the consumer retorting " Oh no you don't ". Remember the *Punch* cartoon published during the war of a suburban couple showing visitors round the house. The householder flings open a cupboard door to show that it is stacked with sugar from top to bottom, and then hastily explains " Of course, the reason we have so much sugar is

that neither of us takes any". Apply that to scarce industrial materials and you see how wasteful and extravagant rationing can be.

The basic difference between the price system and physical controls is well illustrated by the particular example of the allocation of labour. Under a properly working price system, the allocation of labour between employments—not only between industries but between jobs—will be determined by differentials in wages. The skilled worker will earn more than the semi-skilled and the semi-skilled more than the labourer; and the differential in favour of the skilled worker will be sufficient to make it worth while to acquire the skill in question, which often means sacrificing earnings or leisure during a period of apprenticeship. But the differentials will not remain static, for an industry which is expanding and needs more labour will be able to offer higher wages and so be able to attract workers–seeking to better their position–from industries which are static or contracting—yet another example of the general proposition that in a properly functioning price system there are no shortages.

Unfortunately, the wage structure is just one more part of the general price system which has been thrown out of gear by the inflationary conditions of recent years. For fear of provoking still more inflation, basic industries which ought to be expanding are inhibited from bidding up wages in order to attract workpeople away from other industries. But what have those who believe in rationing and controls to offer in place of wage differentials as the means of getting workers into the right industries? Nothing but direction of labour—a measure which involves so gross a violation of the liberty of the subject to choose his occupation that it cannot be tolerated in any democratic community except in the direst emergency.

Here I touch on the core of the matter. What do we value most in our way of life? Surely our liberty. Of all our freedoms, with perhaps the single exception of freedom to choose our job, none contributes more to our real liberty than the freedom to spend our money as we will and to give free rein to our individual choices and desires. Wherever decisions are taken centrally, *some* interference with the freedom of choice of the individual is involved. In other words, the price system is not only more efficient than physical controls, but also more democratic. It is important to stress this because it now seems to be widely believed (often unconsciously) that

the free price system is in some way morally suspect and that rationing and controls are in some way ethically superior and pay greater regard to social values. The truth is the very reverse. Yet there are people about—surely for the first time in our history—who seem to believe that rationing and controls are not only desirable as a normal feature of our economic life but represent an actual advance in economic organization by comparison with the price system. Any such doctrine I regard as a complete fallacy.

PRICE SYSTEM MORE EFFICIENT

For there cannot really be any dispute about the superior *efficiency* of a properly working price system. To demonstrate this, one might easily range over the whole field of economics, so I will confine my argument on this score to three simple points:

First, rationing and controls are merely methods of *organizing* scarcity; the price system automatically works towards *overcoming* scarcity. If a commodity is in short supply, a rise in its price does not merely reduce demand but will also tend to stimulate an increase in its supply. In this, the price system stands in direct contrast with rationing and controls, which tend to make it less profitable, or less attractive in other ways, to engage in essential production than to produce the inessentials which are left uncontrolled. Rationing merely diverts spending away from rationed goods towards other goods. The effect, more especially if a state of inflation is the reason for the introduction of rationing or controls, is to make production of inessentials (e.g. luxuries for the home market) so profitable that the industries concerned are able to attract resources—including labour—away from more essential employment (e.g. export).

Secondly, the price system is dynamic. The administration of any form of control can only be based on the pattern of economic life existing at some date in the past. This gives a privileged position to established concerns and tends to freeze the pattern of industry. It makes it harder, if not impossible, for new products, new firms, new industries to make their appearance. The scales are weighted precisely against those vital and expanding elements in the economy which ought to be encouraged. Think of the period of the Industrial Revolution. How could the industrial structure of this country have been built up if every firm had had its quota of raw material and if

no new firms had been admitted into the circle? I believe it is to the dynamic process of the price mechanism that we owe our standard of living today, and the question is whether without a return to a properly working price mechanism that standard can possibly be maintained in this crowded island.

Thirdly, rationing and controls are expensive to administer. The price system functions without the need for coupons, quotas, licences and the rest. It thus saves us the expense of an army of civil servants drawing up regulations and issuing forms (to say nothing of inspectors and enforcement officers), and an army of people at the receiving end engaged in filling up forms when they too could be more productively occupied.

ETHICS AND EGALITARIANISM

I think that demonstrates the superior efficiency of the price system. There remains the argument that controls are in some way morally superior. The sort of things which are said to arouse prejudice against the price system are such phrases as " rationing by the purse " or " letting things go to the highest bidder." There is a lot of muddled thinking in this. Criticism of the price system is most pronounced on the political Left, yet even Labour Governments permit—do they not?—a great deal of " rationing by the purse." A trade union secretary, for example, is paid more than a labourer, and his larger money income is presumably intended to confer a higher standard of living. Nobody, therefore, is suggesting a completely egalitarian society: that would presumably be communism (though not as practised in Russia where the Commissar is infinitely better off than the worker). It would not be socialism.

Left as well as Right therefore envisage differences in living standards, and those differences will obviously be related to differences in money incomes. But, it is objected, if goods go to the highest bidder they will all go to the rich and the poor will be left without even the bare essentials of life; therefore basic necessities must be rationed (or sold at artificially low prices). This is, of course, the most complete rubbish. In order to ensure that the weak are protected, that even the poorest enjoy a certain minimum standard, all that is necessary

is to see that they have sufficient money to buy the goods concerned at whatever prices are established in the open market—leaving them free, incidentally, to buy the particular goods they want in accordance with their individual tastes and preferences.

Hence the case for protecting the poor is not in the slightest a case for universal rationing or universal subsidization. The price system can perfectly well be adapted to take care of social objectives, and so adapted can ensure a higher standard of welfare than any alternative method. To give the poor sufficient money to cover their essential needs is only one example of this adaptation. One of the stock criticisms of the price system used to be that it takes for granted the existing distribution of money. Obviously, any such criticism is long out of date. It just does not apply to a society in which for decades past we have had estate duties at work breaking up large accumulations of inherited wealth, and in which taxation of large incomes ranges up to 19s. 6d. in the pound.

The danger, of course, is that progressive taxation carried to excess will so discourage thrift, enterprise and hard work that the nation as a whole suffers, and those dangers are becoming daily more obvious—witness the scarcity of risk capital. Any real improvement in the standard of living of the mass of the people must come from higher production, an increase in the size of the national cake to be shared out. Penal taxation which depresses output can only make the rich poorer without making the poor richer. But given a system of progressive taxation there is certainly no danger that a system of free prices will lead to social injustice. And just as the price system can be adjusted to hold the balance between different income groups, so it can be adjusted to achieve other more specific social objectives. If the public prefers to spend its money on cinemas but not on the opera, for example, and if our rulers disapprove of that, then cinema-going can be taxed and opera-going subsidized. I am not suggesting that this is in fact desirable ; but it illustrates the way in which, if a project which is deemed of high social value is not sufficiently profitable to compete for resources with other projects deemed of lower social value, then the price system can be adapted—through

taxation and subsidies—to bring about any result which is deemed desirable on social grounds. (A clear distinction should, however, be drawn between subsidies for specific projects and universal subsidies such as the food subsidies, which seem to me quite the wrong way to achieve the objects in mind.)

One important reason why it is desirable to achieve social objectives through the medium of the price system is that, if the price system is allowed to function properly, it affords an invaluable guide, for which there is no substitute, to the true preferences of the public. If people go on buying a commodity even though it is heavily taxed that is the clearest possible indication that the public place a high value on it. An open subsidy, too, requiring periodical renewal, serves as a reminder that the subsidized project is absorbing resources that could be more profitably employed in other uses. It may well be desirable that resources should at times be diverted from the most profitable use, but it is certain that where this is done it ought to be done with due regard to the cost involved. One of the basic criticisms of other methods of intervening to achieve social objectives—e.g. licences, allocations, quotas—is that they fail to provide any measure of the cost of doing what they set out to achieve. Moreover, once such methods become at all widespread the price mechanism as a whole is thrown out of gear and we lose the services of an invaluable guide to rational economic conduct.

There are, of course, large sections of life, such as education and social amenities in the widest sense, to which the criterion of mere profitability cannot be applied ; but I believe that over the great field of production the capacity to make a profit measures the value to the community of an enterprise, provided that two conditions are satisfied. Those conditions are, first, stability of money and, second, the maintenance of effective competition. It is only under those conditions that the price mechanism can be said to function properly. When that is happening, however, if an enterprise is profitable it is because it is producing something the public wants. It is the fact that the public are willing to pay for it (either as consumers or taxpayers) that results in profits being earned. Profitability,

in fact, instead of being a sign of iniquity, is an indication of service to the community, either because the product is needed or the enterprise is efficiently and economically conducted, or both.

BANK RATE A SELECTIVE WEAPON

These considerations are particularly relevant when we come to consider one section of the price mechanism with which I am especially concerned: namely, the price of capital or the rate of interest. The rise in short-term interest rates in particular has been criticized as throwing an unnecessary burden on the Exchequer. But whatever the cost to the Treasury may be, it is obviously trifling by comparison with the cost of inflation, and I am certain that we could not hope to check inflation so long as interest rates were pegged at their former artificially low levels.

It is, of course, extremely difficult to segregate the effect of higher interest rates from those of other influences which have also been operative. Nor can we appraise the value of the new policies simply by their effect on the domestic public. There can be no doubt, for example, that the increase in Bank Rate to 4 per cent. brought about an immediate and marked improvement in overseas confidence in the pound sterling. Again, so long as the Treasury bill rate was held at ½ per cent., London was the bargain basement of the world for acceptance credits, with the result that the London market was deluged with demands for credit just at a time when it was vital to collect every penny of the export proceeds due to us. No doubt those whose solution for any problem is to introduce still more controls would say that even so the banks could simply have been instructed to cut down the facilities granted. Suggestions of that kind reveal a certain remoteness from the facts of business life. It is surely obvious that it is more difficult to restrict the supply of anything if the demand for it has first been inflated by means of artificially low prices.

Similar arguments clearly apply in the domestic field, for there can be no doubt that the higher charges for bank accommodation have done something to discourage applications for overdrafts for less essential purposes and, even more important, have encouraged borrowers in general to keep down to the

unavoidable minimum their demands for bank finance—thus considerably lightening the task of the banks in seeking to prevent an undue expansion in advances. One way of avoiding recourse to bank accommodation is to run down excessive stocks built up in earlier periods of cheap credit. That is particularly important at a time of crisis in the balance of payments. But could it be done by direct controls? Only the individual business man can judge how stocks can be cut to the bone without impairing the efficiency of his business; dearer and tighter credit gives every business man, individually, the incentive to do so. There are other ways in which higher short-term rates must be helping to damp down inflation. Now that the banks are able to allow 2 per cent. interest on deposit accounts, for instance, customers have at any rate some inducement to leave such balances unspent, to build up additional balances out of current income.

That is part of the answer to the charge that Bank Rate is a blind and indiscriminate weapon. Nothing could be further from the truth. It is often suggested that if ability to raise capital depends on the ability to pay a particular rate of interest, projects of great social value may be excluded while other undertakings, more profitable but of little social value, will be allowed. The term "social value" itself begs a good many questions. But leaving aside this fundamental difficulty, most people would agree that if two projects are deemed of *equal* social value, that should be preferred which involves the lower cost, including the cost of capital. If interest rates reflect the true scarcity of capital, they will correctly measure this element in the cost of any project. A rise in interest rates will tend to discourage—or to encourage the postponement of—projects which absorb a large amount of capital in relation to those which require less capital.

Obviously, this process is by no means blind but highly selective: it enables the community to make the best use of the limited supply of a scarce factor of production—and remember that capital is a very scarce factor at present. If projects considered highly desirable in the national interest cannot pay the market price for capital, then the best course, as I have already suggested, is to provide an open subsidy sufficient to overcome this difficulty. That is infinitely preferable to the provision of capital at artificially low rates or, normally, to a system of priorities—both tantamount to concealed subsidies.

At the moment, this question is rather academic for, as everybody knows, ability to pay a rate of interest is not in fact the sole test of access to credit. The banks have been asked to give priority to industries engaged on defence, export or other essential activities, and the Capital Issues Committee operates a similar system of priorities in respect of long-term finance. Such a system is undoubtedly needed under the present abnormal conditions, when the price system has been dislocated by many years of inflation and there is no longer any presumption, as there would be under a properly working price system, that the things which are most desirable in the national interest will in general also be the most profitable. One effect of the present monetary policies will be to correct this. If money incomes are stabilized, and more has to be spent on essentials, then the public will be left with less to spend on inessentials; the production of inessentials will become less profitable by comparison with more essential activities. And that is imperative if we are to put our resources to their proper use.

CONTROLS GO WITH INFLATION

It is a great pity that people should be so sharply divided about the choice between financial and physical controls, and still more so that this division of opinion should so closely follow the division between the political parties. It is also to some extent unreal. Even a Labour Government, as I have said, necessarily goes in for a great deal of "rationing by the purse." Conversely, nobody would wish to sweep away the existing controls overnight. Many of these, such as exchange control, are made necessary by the facts of our international situation and cannot be abandoned until the balance of payments is put right. For the moment, therefore, the practical issue in the choice between physical and financial controls is merely one of emphasis.

Nevertheless, there are real differences about long-run objectives. Resort to physical controls on so wide a scale as at present indicates that demand exceeds supply in a great many directions at once: in other words, that total purchasing power is excessive. Widespread use of physical controls is thus associated with a condition of inflation. To say that one wishes to cure inflation is therefore the same as saying that one wants to get rid of a good many controls, because in the absence of inflation there would be no case for retaining them.

One can distinguish two main strands in Labour's love of direct controls and its opposition to financial controls. Both of these I believe to be largely based on misunderstanding. The first strand is the belief that the choice between physical and financial controls is the same thing as the choice between planning and *laissez-faire*. But, as I hope I have already shown, the infinitely flexible price system is far better adapted to give effect to judgements about social priorities than are rigid controls. Secondly, and perhaps more important in Left-wing thinking, are the unhappy memories of past deflation and especially the world slump of the 'thirties. It is because of these that so many people believe that monetary discipline of any kind necessarily means depression and unemployment.

Anybody sincerely holding such beliefs is living in the past. It is ridiculous to blame the monetary *system* for mistakes of monetary *policy* which may have been committed in a past age. Such a view leaves out of account the revolutionary change in the climate of economic thinking since pre-war days, a change due very largely to the work of the late Lord Keynes. Given that revolution in economic thought, we are *not* condemned to the choice between inflation on the one hand and deflation and slump on the other hand. Both are disastrous. But there is open to us the middle course of a sufficient degree of monetary discipline to secure a high level of employment *coupled with* stability in the value of the currency. The Britain we have to aim at is a Britain able to pay its way abroad, a Britain with a strong and stable currency and a Britain free from queues.

Assuming we can conquer our immediate difficulties—that is, stabilize our internal cost of living and restore international trade by means of a freely convertible pound—the great issue before us is totalitarianism *v.* democracy, and not only in the sphere of world politics but in domestic affairs as well. For freedom can only be had by free people working a free system, and once encroachments on freedom become excessive you are no longer free. One of the tragedies of our present situation is that so many people who sincerely believe themselves to be democrats are loudest in advocating policies which are in fact authoritarian and cannot be effectively applied without destroying the liberty of the individual.

BALFOUR OF BURLEIGH.

June, 1952.

European Payments—An American View

By Michael L. Hoffman

—of the New York Times

IN contemplating Europe's struggles since the end of the second world war to establish a mechanism for handling international payments one is torn between feelings of elation and depression. It is quite certain that the European Payments Union, whose renewal for another period seems at this writing to be assured, represents great technical progress compared to the hodge-podge of bilateral payments systems hastily constructed after the war. It is just as certain that it represents a great technical decline from the international gold (or sterling) standard, the sheer mechanical beauty of which increases in perspective as the foreground becomes littered with the debris of unsuccessful attempts to do its work.

It is perhaps wise not to dwell too much on the latter comparison. The degeneration of intra-European trade to the level of crude barter between economically nonsensical national states was a real alternative to the payments systems that have been devised since 1945. The international gold standard was not.

It is equally wise, however, not to forget that long after the period of reconstruction, in the obvious sense of the term, might be said to have ended, Western Europe, and indeed the whole Western world, was still a long way from having constructed a system of handling international payments that would bear comparison as a piece of machinery with the marvellous, unplanned mechanism, with London as its centre, that was badly shattered by the war. If we speak of progress, it is progress since 1945 that is involved; not, as with so many index numbers, progress since 1938; much less, that Progress in which the West has been wont to have such firm faith.

* * *

It is perhaps not generally realized today that the effort to break the chains on European trade began before the Marshall Plan itself emerged from the nebulosity of promises and long before the formation of the Organization for European Economic Co-operation. The ministers who met as the Committee for European Economic Co-operation in the summer of 1947 saw almost immediately—and it is greatly to their credit that they did so—that whatever programme of grants and

loans might ultimately be proffered by the U.S. must be accompanied by a programme for improving the European payments system. A committee of experts met in London in September, 1947, and produced a report which put the problem as clearly as need be and pointed out the connection between intra-European payments and the allocation of American aid (then still prospective). It contained, as an appendix, a project designed to substitute for the system of bilateral credits between individual countries (credits which, incidentally, were virtually exhausted) a system of multilateral credits to be extended by each member country to all the other members of the group collectively. This project was drafted by the Benelux delegation and, though rather awkward to operate, would in all essentials have achieved much the same purposes as the E.P.U.

All the main ideas were about in mid-1947, but there was a long road ahead. In November of 1947 the Bank for International Settlements began operating a simple clearing system for the Benelux, the Bi-zone of Germany, Italy and France. Only items that could be offset against each other without giving rise to the need for additional extensions of credit on the part of any member were automatically cleared. The amounts that could be put through the complete circuit over several months time were no more, as the *Manchester Guardian* remarked, " than the Bank of England does in a day or two ". This was clearly not good enough.

In March, 1948, at a meeting in Paris of Hubert Ansiaux of Belgium, Edward Playfair, of the British Treasury, Guillaume Guindey of the French Treasury and Professor Pietro Stoppani of Italy the idea was first discussed of financing a more complete clearing system by using some of the " local currency counterpart " of Marshall Aid: that is, the sums in local currency accruing to the governments of beneficiary countries as the counterpart of the goods and services received under the Marshall Plan and which they were required to lodge on special accounts with their respective central banks. That it was embarrassing and unsatisfactory to have to seek a solution of the general European payments problem through some device tied to the allocation of dollars to individual European countries was as clear to these technicians as to their critics. But it can hardly be disputed that in the circumstances of the time, and in the absence of any leadership from the International Monetary Fund or the U.S. Treasury—two institutions that might have been supposed to have some ideas on the subject—it was a stroke of genius to start along those lines.

This is not the place to review the detailed history of the development from that beginning through the various stages which eventually led to the formation of the E.P.U. There was a steady development from more to less awkward types of settlement, bearing out in all respects Toynbee's thesis that social progress reflects the principle of "progressive simplification". Compared to the first Agreement on Intra-European Payments and Compensations, inaugurated in October, 1948, and operated until June of 1949, with its "first and second category compensations", or to the second agreement of September, 1949, which ran until June of 1950, with its "bilateral and multilateral drawing rights", E.P.U. is a model of simplicity. It is easier to operate and easier for Congressmen to understand. It has much less of a tendency than the earlier schemes to influence the course of trade in a manner that accentuates unbalance and discourages corrections.

In the earlier Payments Agreements of 1948 to 1950, the credit to be extended or received by each member was based primarily on predictions of the surplus or deficit of that country in trade with every other individual member country during a specific period. These Agreements therefore relied heavily for their successful functioning on these predictions proving reasonably accurate. The outstanding feature of E.P.U. is that it established a relatively automatic payments system whereby each member country can settle its accounts with all the other members taken together. Hence successful prediction is much less vital to the smooth working of E.P.U. than to that of its precursors and unsuccessful prediction much less of a disaster. Each member is allocated a "quota" and settlements are based on the cumulative debit or credit in trade with all other members since the inception of the scheme. During the first two years of operations no gold was payable to the Union in respect of a deficit, or receivable from the Union in respect of a surplus, which did not exceed 20 per cent. of the member's quota. This has now been changed so that only the first 10 per cent. of the quota can be borrowed from the Union without any gold payment. Thereafter, a proportion of any deficit must be settled in gold, the proportion being determined by a sliding scale related to the debtor country's quota. Creditors, on the other hand, will continue to receive in gold half of any additional surplus above 20 per cent. of their quota.

During the period October, 1948, to June, 1950, the balances remaining to be settled by the use of "drawing rights"

(credits from one country to another) were more than three times as great as would have been the case had E.P.U. already been in operation, for the reason that under the E.P.U. many more debits and credits would have been cancelled out against each other during the process of clearing. During that period, compensations in fact disposed of only 22 per cent. of the total of all monthly bilateral deficits; under E.P.U. 72 per cent. could have been so settled. During the period down to the end of April, 1952, when the E.P.U. was actually operating, 73 per cent. of all bilateral deficits were cleared; about 6½ per cent. were settled by gold payments; about 15½ per cent. by use of credit, and the rest by utilization of "initial balances" thrown into the E.P.U. pot at the start and by special resources made available by the U.S. Government to Greece, Austria, Turkey and Iceland. This is not a bad record of efficiency.

* * *

From the beginning, and even before, the E.P.U. has been subject to several tugs of war. There has been the force, anchored in London, seeking to make it into a kind of insurance against gold losses arising from the trade between the sterling area and the Continent, tugging against the force, anchored in Brussels, seeking to make it into a kind of automatic machine for siphoning otherwise unobtainable dollars into the pockets of the European creditors. One branch of the U.S. Government has bitterly fought the grant of gift dollars to an agency which looked, through some sets of glasses, like a device for perpetuating universal discrimination against dollar goods. Another branch of the same Government has, with some success, fought for support of E.P.U. even at the cost of driving countries on the verge of full convertibility back into the pen with the rest. One faction has regarded the exhaustion of a quota as a disaster to be prevented at all costs. Another has felt that continuous adjustment of credit margins to accommodate unforeseen changes in balances of payments was a negation of the whole principle on which E.P.U. was founded.

By far the most important dispute has been and is over the question whether the E.P.U. was a good idea in the first place. There were many very influential central bankers and others who believed, in the second quarter of 1950, that the right road for Europe was to bring across the line into convertibility those countries then capable of making the jump. Thereafter they would have dealt separately—from the viewpoint of U.S. aid—with the problems of the convertible group and the

inconvertible group respectively. Eight months after the devaluations of 1949 a good technical case could have been established for making the Belgian franc, French franc and Italian lira fully convertible currencies, with parities notified to the I.M.F., and for allocating a portion of the second year's Marshall Aid for the purpose of keeping them convertible.

This project of a "nucleus" of hard currencies appealed to all who feared the effects on European costs and competitive power of continued protection against dollar competition by both foreign exchange and import controls. While discriminatory import controls were already negligible in Belgium and Switzerland, they could not have been removed at once in France or Italy (although removal could have been pushed a lot farther had it been made an objective of policy instead of something axiomatically excluded). But it was widely believed that convertibility and a modest beginning toward the scaling down of import controls could have been supported by these countries with no increase in the aid they were likely to receive anyway (except possibly in the case of Belgium), provided that aid were given in a form that would make it usable for stabilization purposes.

What really pushed this thesis aside was the unwillingness of the U.S. authorities to risk the whole aid programme by introducing an element that would be difficult to explain to Congress, particularly during the process of getting another year's aid bill through. It would still have been necessary to give aid to the inconvertible countries. It would still have been necessary to put some dollars behind a scheme for enabling them to trade with one another and with the new convertible group. Instead of one E.P.U. there would have been three kinds of payments networks to fit into the aid programme and explain. This was too much.

The convertible nucleus was forced into the catch-all E.P.U. When, later, an issue arose in U.S. inter-departmental circles over whether Belgium was to be urged to cut dollar imports in order to accommodate her payments more to the necessities of E.P.U., or to maintain non-discrimination so as to conform with general U.S. policy in the trade field as exemplified in G.A.T.T., the E.P.U.'s victory was almost complete. The American urge to produce European "integration," of which E.P.U. had become perhaps the greatest symbol, overcame the American interest in the support of national economies capable of maintaining non-discriminatory trade and payments relationships with the dollar world.

There are signs that the pendulum may be swinging back in Washington. The flat refusal of the Administration to consider putting any more aid funds into the E.P.U. reserve, and the growing pressure from the civilian side for a very large increase in U.S. military expenditure within Europe instead of in the United States, suggest that the experience of the past two years has strengthened rather than weakened the doubts of those who feared that the E.P.U. would be a much too comfortable half-way house on the road to full monetary and economic independence. This statement requires some background and some explanation.

There can be no doubt of the validity on the technical level of the case for a larger E.P.U. reserve. By the end of June, the managing board has estimated, the Union will have had a total of \$442 millions in convertible resources at its disposal. It will have more than \$300 millions actually on hand; and the fact that the Union still has in hand so large a proportion of its original dollar resources is directly due to the very large deficits of the sterling area, requiring heavy settlements in gold, towards the end of the period. Should the British deficit turn into a surplus of, say, \$400 millions in a quarter—a movement quite in keeping with recent fluctuations—the Union would be required to pay out \$242 millions of gold. The board estimated that it needed another \$178 millions of liquid reserves. A total of \$620 millions in gold and dollar resources would not be an enormous base for a system with an annual turnover of \$4,000 millions. The board did not, in the outcome, get a firm promise of additional reserves. It did get an alteration in the rules so that debtors will have to start paying gold into the pool sooner than before—after using up only 10 per cent. of their credit quota. And it got a guarantee that the reserve would in no case be allowed to drop below \$100 millions.

It is worth remarking parenthetically that when U.S. officials have used fear of Congressional opposition as one argument against contributing more to the E.P.U. pool, they are either deliberately or unconsciously evading the issue. U.S. officials have been consistently wrong about Congressional reaction to the use of dollar aid for supporting programmes to keep intra-European trade moving, as contrasted with programmes for financing the shipment of goods from the U.S. to Europe. For more than a year after officials were convinced that the payments problem was the heart of the recovery problem, the E.C.A. refused to put anything like E.P.U. up to Congress, for fear of being chastized for spending money on

foolishness. When it was explained to the Committees in 1950, the group from the two Houses that met to iron out differences in the legislation after its first trip through the Senate and House not only approved a contribution to a European payments union but provided twice the amount actually used for E.P.U. and added another $600 millions to assist countries risking financial loss by the liberalization of their trade policies. There was the same coyness this year in asking for money for financing procurement in Europe under the Mutual Security programme. In fact, the House not only grasped fully why such expenditures were necessary, and not only authorized the use of funds for that purpose, but specified that $1,000 millions should be used for nothing else. Congress is not as dumb as U.S. officials often seem to think.

* * *

The view that E.P.U. should now stand on its own feet without a further direct contribution of American resources seems to be compounded of a number of doubts of a more fundamental nature than fear of Congress or disagreement with the technical case for a larger reserve. Leaving aside the views of those who believe the Union is positively bad for Europe (a view not restricted to U.S. Treasury, or even to U.S., circles), there is still great uncertainty whether it is precisely what is needed at the present juncture. The managing board is quite right to point out that an effort to liquidate the Union now might cause a reversion to bilateral chaos and would certainly give rise to a contraction of European creditors' exports; but that does not in itself prove that continuation of E.P.U. or an expansion of its scope would be good. It may well be, and this is apparently the dominant American view, that E.P.U. has already shown off all it can do for Europe and that what it cannot do might as well be tackled now as later, without investing in a further experiment to see if a bigger E.P.U. could not do more.

The danger inherent in E.P.U. from the start, from the viewpoint of those who believe Europe should be working toward convertibility, has been that every time a country became a substantial creditor the pressure on that country's central bank to increase credit would become irresistible. The early record of the Union was rather alarming in this field. The recent record is rather more reassuring, but the danger is still there. Nobody could accuse the National Bank of Belgium of being an easy touch for more credit. But it is a fact that both

Belgium and Portugal have been subjected to great pressure, and have felt constrained to give in to it from time to time rather than cross completely over the hard currency line.

Belgium's difficult wrestling match with her problem of export finance has been watched by all Europe and it is by no means certain who has won. But it cannot be doubted that E.P.U. functions in a manner to make the Belgian economy practically incapable of behaving in a " corrective " manner. Normally, a country running a persistent export surplus will thereby accumulate monetary reserves and hence be in a position, if it so desires, to expand domestic credit and allow monetary incomes within its area to rise, without fears for the external position. Admittedly, creditor countries have not always shown themselves *willing* to institute such corrective action. But a creditor in E.P.U. is not even placed in a position to do so, for the credit with the Union which forms the counterpart of its export surplus cannot be treated as a primary or even a secondary foreign exchange reserve. Indeed, the position is even worse in that the credit which a country has agreed to extend but which has not yet been drawn upon should probably be regarded as a " mortgage " upon its actual monetary reserves, since the provision of exports on credit is likely to involve some loss of reserves. The National Bank of Belgium, for example, treats its potential liabilities to extend credit to E.P.U. as a mortgage on its gold reserve, and by the spring of 1952 half Belgium's gold reserve was so mortgaged. This is not a situation that encourages men like Governor Frère to sanction expansionist internal policies. On the other hand, the export industries have become absolutely dependent on a continuation of central bank or government finance, so the deflationary axe falls mainly on sectors of the domestic economy already too long deprived of finance for modernization and development of the nation's resources.

Nor has the interaction of E.P.U. with trade policy been altogether reassuring. It may be too cynical to say that its only accomplishment on balance has been to force Belgium to discriminate against dollar imports, but the net effects of two years of " liberalization " under the E.P.U. régime seem very small indeed. First one country then another has pranced gingerly up to the 75 per cent. target and then shied away at the first sign of trouble. As the Netherlands, Denmark, Germany found it possible to advance toward the target, Britain and France have had to make a simultaneous retreat. " E.P.U. will make no sense unless it is accompanied by an appropriate

commercial policy on the part of its members", stated the official guide to the programme issued by the O.E.E.C. in July, 1950. "Appropriate" was translated into the liberalization programme expressed in the Code of Trade Liberalization, containing policy guidance for debtors and creditors. But the 75 per cent. limit itself has proven to be a slippery standard capable of being reduced to absurdity by the exclusion of state trade. A sounder approach is the "common list", consisting of an agreed list of commodities—mainly raw materials and semi-manufactures—on which quantitative import restrictions are in principle to be abolished by all E.P.U. countries. But the common list is very small and many countries have accepted it only with reservations that greatly weaken its resistance to attack. The latest round of British restrictions have apparently done a great deal of damage to the common list. The essential evil of quantitative import controls is the ease with which they can be adjusted to meet month-to-month shifts in the balance of payments, thus saddling all the trade with a high uncertainty premium. This evil is not much smaller today than it was in 1950. Even if 75 per cent. liberalization had in fact been attained, would it be something of which Europe should be proud? And has liberalization been great enough or durable enough to "make sense" of E.P.U.?

* * *

However admirable an institution it may be for registering the gains of one set of European countries at the expense of another set, the E.P.U. cannot be given really good marks unless it becomes more than a mere recorder of changes and begins to exert a reciprocal influence on the changes themselves, and in the "right" direction. The beginning of a new technique of collective review of national monetary and trade policies led to some hopes that the Union's control over quotas and the extension of special credits to members might put it in a position to develop into a kind of European central bank, able to exert its influence towards appropriate policies of expansion and contraction in the various monetary areas in a manner to encourage the achievement of better balance in the international accounts. In the case of Western Germany in 1951, the grant of credits made conditional on the adoption of corrective policies recommended by an international team was followed by rather spectacular results. In the case of the Netherlands, the desire to avoid facing a similar inquisition into the origins and nature of the Dutch trade deficit was a powerful factor in inducing

politicians to adopt the financial reform of the late spring of 1951, which also brought highly satisfactory results in improved accounts with E.P.U.

Given time, and sufficient immunity from disasters originating outside the E.P.U. community, it is possible that there might be developed through E.P.U. a technique of collective responsibility for national monetary and financial policies affecting balances of payments. Unfortunately, when the big tests came along, with the recent swing-over of Britain and France to debtor status, little was heard of collective review of the policies responsible for these changes. A Western Germany anxious to be accepted in the community of nations can be dragged into the international clinic and put under the X-ray machine. But Britain and France still act unilaterally and negotiate with their protesting neighbours later. For better or worse, the time is not yet when experts from the E.P.U. can tell Her Majesty's Government to cut more off food subsidies and raise Bank Rate to six per cent.

At best, the embryo corrective mechanisms that may be discerned in (and around) E.P.U. can affect only that part of the problem capable of solution within Europe. There are some who would argue that so far as the Continent is concerned the entire balance-of-payments problem is capable of solution within Europe, that Europe-generated inflation is the cause of the problem and that where Europe-generated inflation has been suppressed the problem has disappeared. But the sterling area is in the E.P.U.; and hardly anybody would argue that the balance-of-payments problems of the sterling area are capable of solution solely within the United Kingdom, in the sense that any conceivable domestic financial and monetary policy on the part of Britain alone, without corresponding action by the rest of the sterling area, would suffice. The evidence is all the other way. One of the most disturbing comments on the post-war European balance-of-payments problem is the statement, in the Economic Commission for Europe's Survey of 1951, that " The balance-of-payments history of Europe and of the U.K. in particular during the past two years can be told largely in terms of the boom and collapse of the market for three raw materials produced mainly outside Europe—rubber, wool and tin ". This same survey emphasizes the tremendous burden carried by the British economy because of the drain " without clearly definable limits " of goods into the sterling area, large parts of which are " immune to any but the most severe and protracted over-importing " and feel no " direct

pressure as far as their own reserves are concerned to curtail imports from other [non-British] sources".

The tremendous fluctuations in the balance of the sterling area with the non-sterling world are too big to be compensated by any conceivable adjustments through the E.P.U. or within the area affected by collectively-agreed policies designed to make the E.P.U. function properly. It would be too cynical to regard E.P.U. merely as an additional reserve for the sterling area, for in the early stages it was the sterling area that was extending large credits to the Union. But E.P.U. has in effect been such an additional reserve behind sterling for many months past. Considered as such, it is too small to add greatly to the stability of sterling. If the sterling reserve were great enough to accommodate a deficit of one billion dollars a quarter (gold and dollar losses in the fourth quarter of 1951 were $934 millions) for long enough to get a corrective programme launched, the Bank of England could do the clearing and the E.P.U. could fold up without depriving Europe of any essential mechanism.

The existence of E.P.U. is a standing rebuke to sterling. Sterling has had its revenge by saddling the organism with burdens that may be its undoing. The inter-area convertibility of sterling has proved to be an excellent vehicle for spreading inflation. What is not clear is whether it can survive without very much more successful co-ordination of efforts to halt inflation in various parts of the sterling world. The financial world was given to understand that meetings in January, 1952, among sterling-area financial officials produced solid results in the way of greater co-ordination of policy among area monetary authorities. It is not yet clear just what these achievements may have been. It seems certain, however, that from the viewpoint of a number of members of the area the present struggle to re-establish the sterling reserves is in the nature of a last chance for the system.

It is, from many points of view, an admirable thing that the United Kingdom has been pouring out its substance in exports to the rest of the sterling area during the past six years (to the extent of a net export surplus of just over £1,000 millions) and that the free movement of capital within the area has made it possible for a £900 millions capital outflow to help finance this operation. Countries like India and Australia certainly need capital imports. But, from the outside, the spectacle is hardly one to inspire confidence in the system. If obedience to the sterling area's rules during a period like the present obliges the banker to finance the sterling partners

willy-nilly at such a rate and, indeed, to add to their capacity to increase the drain on British resources (to the extent of a £335 millions net increase in sterling balances during the six years ending with 1951), the question is bound to arise whether it may not be the rules of the sterling system that will have to be changed.

The principal justification for the continuance of the E.P.U. today in the face of all its weaknesses is that doubts about the capacity of sterling ever to assume the rôle of a clearing currency for Europe are very strong in the world. If it has proved only a half-way house on the road to full convertibility—which, it is important to recall, remains the ostensible goal of all its members—the Union does seem to have brought members a little farther along the road than they would have got if some of them had been absorbed in the sterling area while others had made abortive attempts at convertibility and then, under the pressure of heavy discrimination, slipped back into a comfortable softness. It may be that in holding the group in the half-way house E.P.U. is doing about the best that can be done under the circumstances of today.

* * *

The E.P.U. would have had a hard row to hoe in any case. During the E.P.U. period the trade deficit of Western Europe with the dollar area (the main variable in the current accounts) has been: \$483 millions for the second half of 1950, \$853 millions for the first half of 1951, \$1,411 millions for the second half of 1951 and possibly a similar figure for the first half of this year. Nearly all this has been due to increasing import costs. Exports rose steadily until the end of 1951 and have since shown no marked trend, except for France where inflation has again priced many things out of the market.

E.P.U.'s only chance of leading its flock toward convertibility was by functioning in an exemplary manner itself in a milieu in which all members more or less behaved, which they have not, and doing this in association with a gradual decline in Western Europe's dollar deficit. How far and how fast this needs to decline for a fair " balance " in the accounts is a very complicated matter which would lead us back into the inner workings of the sterling area. But I think it unlikely that anyone would argue that an increase in the Western European dollar deficit was compatible with successful advances toward convertibility. Certainly the E.P.U. was founded on the opposite assumption.

What was needed from the American side was a clear

recognition that by mid-1950 the outstanding immediate need of the Western European system was for adequate monetary reserves. The stage had been set for Europe's participation in an expanding world economy. The great strains of rearmament would demand every bit of flexibility that international specialization could provide; but flexibility is precisely what economies worried about their reserves cannot permit. The American contribution to E.P.U. was a kind of half-hearted recognition of these truths. But the vast machinery of American aid went lunging along in another direction, and one that has proved extremely costly to all concerned.

There has, in fact, been what amounts to a collapse of American economic foreign policy since the switch-over from the Marshall Plan to "defence support" aid became, or was thought to have become, a political necessity in 1951. The tremendous success of the Marshall Plan in aiding Europe to revive production and to support a more open payments system was not consolidated. U.S. aid has been provided mainly in a form that is as nearly completely useless as any that might have been conceived: military equipment, the servicing and, indeed, even the use of which requires the growth of production of various kinds in Europe that accentuates the strain on payments balances. The stockpiling programme for eight or nine crucial months was operated not only in disregard of, but in flat contradiction to, the stated interest of the U.S. in putting Europe in a position to bear most, and eventually all, of its own defence burden. Promises about delivery of military supplies were made and not kept. Commitments were extracted from European governments on the basis of estimates of dollar expenditures by the armed forces in Europe which those involved in the negotiations were not in a position to bring about.

No real examination of the U.S. rôle in world economy has been made since the Gray Report, prepared at the request of the President to examine the international economic position of the United States and recommend appropriate long-term policies, which was completed just after the outbreak in Korea. It is hardly ever referred to any more, not because its main thesis—that the dollar shortage is an American problem—has been rejected but because nobody wants to admit the political consequences of its being true. It is easier to go on appropriating money. There has been a revival of protectionism in the U.S., fought only by a small but valiant band in the State Department and a few private organizations, just when a great effort to develop American markets for European products

might have achieved spectacular success in view of the U.S. supply position. It may not result in a reversal of U.S. policy in favour of expanding imports but it has scared Europe and made it difficult to do more than hold the line at a time when a great advance was called for.

The best chance to create a nucleus of hard currencies in Europe and to employ a flexible policy of aiding Europe to restore its monetary reserves has gone. The sterling problem looks as difficult as ever. It will take time to get back into a position in which enough of the factors are favourable to warrant taking new risks on loosening up the payments systems with which the world, for its sins, is cursed.

If there are hopeful signs, and there always are, they must be sought in a growing sense of realism in Europe about the relationship between domestic finance and international solvency, in the very encouraging tendency of Europe to attack U.S. protectionism openly and head on, and in the growing realization in the U.S. that the joint defence effort is going to last a long time and *is* " joint ". On the dollar problem as such, perhaps the most hopeful sign is the readiness with which Congress has accepted the logic of the need for " off-shore procurement " in the widest sense of the term, i.e. the expenditure of appropriated funds outside the United States. This is part of the process of realizing that the defence of the West is a continuing responsibility of all concerned.

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It is interesting to recall that in the summer of 1950 two plans were put up to the E.C.A. for solving the payments problem. One was what eventually became E.P.U. The other was a plan based on extensive " off-shore procurement ", the dollars being injected into the stream of European payments by direct purchases in the participating countries. The off-shore alternative was rejected at the time, partly because the E.P.U. fitted better into the psychology of promoting " integration ", there being a new institution to set up and talk about, and partly because it was feared that European countries would be too reluctant to sell for European currencies if they could hold back and sell to the same customers for dollars.

The E.P.U. has done about all it can on the psychological plane. And the argument that there should be more European creditors has ceased to have any great relevance. But, most important of all, " off-shore " operations now can be made to cover very substantial purchases by the U.S. of military items that would otherwise have to be bought anyway in the U.S.,

generally at higher prices, both for its own and for allied forces. To shift more of the production burden to Europe would make the problem of gradual transition to self-support by European armies easier than if all equipment is made, and has to be replaced, in the U.S.

A large programme of procurement in Europe is by all standards the most effective way American aid can be extended at this time. It is a means of providing European countries with dollars that can be used for reserves, which by now is clearly recognized as a prime necessity for any progress towards a better payments system and, indeed, to keep the present one going. Of at least as great importance, it is a more mature way of injecting dollars into the world payments system. The development of a habit of using American financial resources outside the United States, to procure something that the United States needs for itself or to fulfil commitments to its allies, is perhaps the only way presently open to get away from the demoralizing notion that the United States is " giving aid " while other countries are " receiving aid " in what ought to be a joint venture. If such a programme materializes, and can be forced down the throat of a reluctant military establishment, riddled with prejudices against " foreign " goods, a new road may be opened ahead. It is not inconceivable that within a year the U.S. Administration may be able to tell Congress that no more " aid " is needed, merely authority to spend a small fraction of the money appropriated for defence purposes outside the American economy. A good deal depends on how successful European producers and governments are in removing the technical obstacles to large-scale procurement with American funds, particularly reluctance to meet unfamiliar specifications and to accept orders requiring long production runs.

It seems that a great deal of work has to be done over again. The big problems remain essentially the same: to continue the high post-war rate of investment in Europe and the growth of productivity throughout industry and agriculture (for if we cannot out-produce the Communists all the rest is of no use); to straighten out the sterling area so it is not an uncontrollable engine of inflation; to reverse the historic protectionist policy and, more important, the protectionist attitude of the United States. Last of all, perhaps, comes the problem of mechanism. The mechanisms can easily be created.

Geneva,
June, 1952.

MICHAEL L. HOFFMAN.

Some Aspects of United Kingdom Export Trade

By Professor Ely Devons

I

THE post-war period has seen a remarkable, if not altogether steady, expansion of British export trade. After the drastic reduction of the war years—the volume of exports in 1944 was less than a third of that of 1938—trade recovered rapidly and, even by 1947, the volume of United Kingdom exports exceeded the immediately pre-war level by a substantial margin. Further increases in 1948, 1949 and 1950 raised the level in the latter year to over 70 per cent. above that of 1938. It was not until 1951 that the expansion showed clear signs of slackening, and now there is some doubt whether the volume reached in 1951 can be maintained.

In retrospect, therefore, 1951 may turn out to have been a peak year for British export trade. Hence the moment is an opportune one to review some of the major characteristics of this post-war expansion. This article deals with three main aspects of this subject. First, the changing composition both by commodity and customer of British exports compared with pre-war; second, the extent of the revival of German and Japanese trade, with particular reference to the effect on British trade of renewed competition from these two countries; and third, the significant features in the movement of British export prices. The review is mainly concerned with long-term trends and has little relevance to the problem of immediate export prospects, except in so far as light is thrown on these by an examination of the longer-term position.

II

THE CHANGING COMPOSITION OF BRITISH EXPORTS

An examination, in Table I opposite, of the movement of the volume of British exports by the main categories since 1935 shows clearly the changing composition of British exports.

Two main groups—raw materials (mainly coal) and cotton goods—show a marked underlying downward trend. Exports of woollen goods, clothing and iron and steel were relatively stable over the whole period. The main expanding sections were the metal-based and engineering group (vehicles, machinery, electrical goods, and cutlery) and chemicals. It is of interest to note that those groups which have expanded most since the end of the war were also those which were

expanding relatively between 1935 and 1938; but the pre-war trend has been strongly reinforced since 1947.

TABLE I
Volume of United Kingdom Exports
1935 = 100

	1938	1947	1950	1951	1st Qr. 1952
ALL EXPORTS	99	107	173	178	185
Raw Materials and articles mainly unmanufactured	90	22	48	33	39
Articles wholly or mainly manufactured	99	121	196	204	213
Declining :					
Cotton yarns and manufactures ..	75	32	50	53	47
Relatively stable :					
Woollen yarns and manufactures ..	77	68	117	104	82
Apparel	90	123	114	123	105
Iron and steel and mnfrs. thereof ..	88	94	148	132	136
Expanding :					
Non-ferrous metal manufactures ..	85	147	196	145	169
Chemicals, drugs and dyes	97	135	199	257	254
Cutlery, hardware and instruments ..	104	190	247	276	313
Electrical goods	128	209	304	306	352
Machinery and parts	123	195	294	312	359
Vehicles	141	260	551	572	616

The changing composition of trade also comes out clearly if one examines the contribution which each of the major groups makes to the total of exports, as set out in Table II overleaf. This reflects the movement of relative prices as well as the changing volume of trade. These figures show how much the United Kingdom now relies on trade in metal and engineering products. Iron and steel manufactures, non-ferrous metal manufactures, machinery, electrical goods, cutlery and vehicles together now account for over half total British exports. With the declining demand for consumer goods—especially textiles—this predominance of metal and engineering products is likely to become even more marked. The outstanding expansion is in vehicles, a group which covers ships and aircraft as well as motor vehicles and which now accounts for nearly 20 per cent. of British exports compared with only 9½ per cent. in 1938.

The interpretation of these changes is not easy; for in the circumstances of the post-war period a relative or absolute decline in some line of exports cannot be assumed to be due to a fall in demand overseas or to increasing difficulties of British suppliers in competing with other countries. In many cases a failure to expand exports has been due rather to a shortage of supplies. Thus the low level of coal exports is largely due to the reduction in the level of total production and the increased

demand at home. Similarly, because of a general shortage of steel, exports of crude steel have been rationed throughout practically the whole of the post-war period.

The decline in cotton goods is rather different. World trade in cotton goods has now been falling, practically without interruption, for the last forty years, mainly because of the rapid growth of domestic cotton industries. This trend was reinforced during the recent war. Hence, the underlying trend in cotton exports was clearly downward, even though it is true that in the immediate post-war years a greater volume could have been sold had supplies been available. Although world output of cotton goods in 1951 was well in excess of pre-war, world trade reached only three-quarters of the pre-war level in 1950. Even before the major recession in world textile production and trade which developed late in 1951, there was strong evidence of a declining tendency in trade in cotton goods.

In addition to this over-all decline in world trade, the United Kingdom has had to meet growing competition from other suppliers—in the pre-war years particularly from Japan. In the immediate post-war period Japan was out of world markets, but her trade has shown signs of rapid recovery since 1948. However, the volume of Japanese exports of cotton goods is still much below pre-war level, and further pressure from Japanese competition must be expected. Competition in some

TABLE II

U.K. Exports: Distribution by Main Groups of Commodities

Percentage of Total Exports

	1938	1951	1st Qr. 1952
	%	%	%
Raw Materials	**11·9**	**3·7**	**3·9**
Coal	7·9	1·1	1·5
Manufactures	**77·5**	**88·1**	**88·4**
Cotton yarns and manufactures	10·6	8·1	7·0
Woollen yarns and manufactures ..	5·7	6·9	4·7
Other textiles	3·4	4·0	3·6
Apparel	1·9	1·8	1·4
Iron and steel and mnfrs. thereof ..	8·9	6·2	6·7
Non-ferrous metal manufactures ..	2·6	2·7	3·2
Chemicals, drugs and dyes	4·7	5·5	5·7
Cutlery, hardware and instruments ..	1·9	2·4	2·7
Electrical goods	2·8	3·8	4·2
Machinery and parts	12·3	14·2	15·7
Vehicles	9·6	18·6	19·4

of the United Kingdom's chief markets is likely to be severe, because Japan is now virtually cut off from some of her most important pre-war markets in the Far East, particularly China.

A new feature of international trade in cotton goods—although there were some signs of it in the 1930's—is the development of a substantial export trade by some of the newer countries such as India and Brazil, and the continued high level of exports from the United States. India is now a keen competitor with the United Kingdom in most Colonial Empire markets and Brazil has captured an appreciable trade in South America. The continued strength of United States competition is more surprising. Before the war the United Kingdom had little difficulty in competing with the United States in world markets for cotton goods, and United States exports were practically limited to countries, such as the Philippines and Central America, where there were special circumstances in her favour. But now United States exports are much more widespread.

The most striking example of this change is in Canada. Before the war the United Kingdom supplied over one-half of Canada's imports of cotton piece goods and the United States less than one-third. Since 1948 the United States has supplied three-quarters of a much increased Canadian import trade, while imports from the United Kingdom are now (1951) only 6 per cent. of the total. It is difficult to tell how far the virtual disappearance of the United Kingdom from this most important market is due to price differences compared with the United States, and how far to the inability of British exporters to deliver cotton goods of the right style and quality promptly. If the United Kingdom cannot compete effectively with the United States in such a market as Canada, where there is still a tariff preference in favour of British cotton goods, the prospects of her being able, without special protection, to compete in other markets with countries such as Japan and India —whose prices for cotton goods are much lower than those of the United States—is perhaps even more gloomy than is generally recognized.

It has already been noted that among the expanding items of trade, vehicles is the outstanding group, whether one considers the increase compared with 1947 or pre-war. Vehicle exports in 1951 were in volume about four times the pre-war level; the other important export groups that have expanded over the period—machinery, electrical goods, and chemicals—were all about two and a half times the pre-war level in 1951.

Most of the items in the machinery and electrical goods groups are capital goods for investment projects and, so long as a high level of economic activity continues overseas, a continued increase in the demand for such capital goods can be expected. The vehicle group covers aircraft and ships as well as motor vehicles, but it is in motor vehicles that the most rapid expansion of exports has taken place.

The future of international trade in motor vehicles raises many interesting questions. One of the most important is how far the capture by the United Kingdom of a substantial part of this trade reflects the movement of underlying competitive forces in Britain's favour, and how far merely the peculiar and transitory conditions of the immediate post-war years. In 1938, of total United Kingdom production of 448,000 private cars and commercial vehicles, only 83,000 (about 19 per cent.) were exported. By 1951, production had increased to 735,000 vehicles and exports to 528,000—over 70 per cent. of total production. This outstanding change was made possible by the combination of two factors. First, a tight limitation of supplies to the home market; second, the fact that throughout most of the post-war period the number that could be sold overseas was determined by what could be made available rather than by the state of demand. The United Kingdom enjoyed a strong preferential position in many markets over the United States—until recently the only other important supplier of motor vehicles—because of the general dollar shortage and because of the strong pressure of home demand for vehicles in the United States. For although production in the United States has increased—from 4·8 million vehicles in 1937 to 8·0 millions in 1950—the whole of the increased supplies went, by contrast with the United Kingdom position, to the home market: exports in 1951, at about 400,000 vehicles, were no greater than in 1937.

Thus the major part of the expansion of international trade in motor vehicles has been supplied by the United Kingdom. It is difficult to judge whether the United Kingdom would be able to hold this position if the United States were able to export more, either through reduced demand at home or further increases in production; or if the United Kingdom ceased to benefit indirectly from the special protection of discrimination against dollar imports in some of the most important markets. The diversion of a substantial part of motor vehicle capacity for armament production both in this country and in the United States complicates the immediate situation. It is,

however, interesting to note what a large proportion of British vehicle exports goes to markets where she is, for the time being at least, protected against substantial United States competition —the Empire alone took 65 per cent. of such exports in 1951. By contrast, United States vehicle exports are mainly to North, Central and South America, which between them took two-thirds of the total in 1951.

There are only a few markets where supplies from the United Kingdom and the United States meet in substantial quantities: Belgium, Holland, Sweden, Switzerland, Turkey, Canada, Brazil, Uruguay, Egypt and South Africa. Changes in our share of these markets should be indicative of the strength of our competitive position compared with the United States. Germany has developed a substantial trade in motor vehicles in the last two years—especially in Europe and her traditional markets in South America. France also has a considerable trade, both with Europe and the French Colonies. There is every indication that when the switch of capacity to armament production no longer limits supplies, competition in international trade in motor vehicles is likely to be much more severe than it has been in recent years.

III

THE GEOGRAPHICAL DISTRIBUTION OF TRADE

Compared with the great change in the commodity distribution of British export trade since pre-war, the distribution of trade by countries has been relatively stable, as will be seen from Table III overleaf.

There was a trend in the 'thirties towards increasing dependence on Empire markets and this has continued in the post-war years. Exports to British countries accounted for 55·5 per cent. of the total in 1951, compared with 50 per cent. in 1938 and 48 per cent. in 1935. Australia stands out as contributing a major part to this increased importance of Empire markets[1], but the increased shares going to West Africa, the Rhodesias, Malaya and New Zealand are also significant. By contrast, the proportion going to Canada has hardly changed, notwithstanding the dollar export drive, while that going to India, Pakistan and Burma has fallen.

In foreign markets the importance of Europe has declined, only partly because of the much reduced trade with East European countries. The share going to the United States is

[1] Australia alone took over 12 per cent. of British exports in 1951 and in that year was by a wide margin the biggest single market for British goods. The importance of this market to the United Kingdom makes the recent import restrictions a particularly severe blow.

slightly higher than in 1938, but United States imports were very low in that year. In any case, the slightly increased proportion going to the United States is more than offset by the smaller proportion going to the other dollar markets of Central and South America.

TABLE III

United Kingdom Exports:
Distribution by Main Markets

Percentage of Total Exports

	1935	1938	1951
	%	%	%
British Commonwealth	**48·0**	**49·9**	**55·5**
Canada	5·2	5·0	5·3
Australia	6·9	8·1	12·6
New Zealand	3·2	4·1	4·3
South Africa	7·9	8·4	6·4
Rhodesia	·6	1·0	1·5
West Africa	2·2	2·0	3·0
Kenya	·4	·6	1·0
India, Burma and Pakistan	8·9	7·7	6·7
Malaya	1·7	2·4	3·4
Hong-Kong	·6	·8	1·4
Other Countries	10·4	9·8	10·0
Foreign Countries	**52·0**	**50·1**	**44·5**
Western and Southern Europe	19·2	16·8	13·9
Scandinavia	8·2	8·7	10·0
Eastern Europe	3·3	4·5	·6
Dutch, Belgian, Italian, French and Portuguese Empires	2·2	2·0	1·9
United States	5·4	4·4	5·3
Central and South America	7·5	7·7	6·2
Other Foreign Countries	6·4	6·2	6·5

The changing position of the United Kingdom in the markets of the world can also be seen from a comparison with pre-war, in the table opposite, of the percentage of total imports which each country takes from the United Kingdom.

In the Empire, a much reduced proportion of their total imports is being taken from the United Kingdom by Canada, India and South Africa. The United Kingdom also commands a smaller proportion of the trade of many European countries; this, no doubt, reflects the expansion of German trade which, as is noted later, has been particularly marked with European countries in the last two years. The declining share of British trade in Central and South American markets is also very noticeable.

The fall in the share of Canadian imports supplied by the United Kingdom is particularly serious, because Canada is one of the most rapidly expanding markets of the world. The reduced proportion of cotton imports taken by Canada from the United Kingdom has already been referred to. This is matched by similar but rather smaller reductions in practically every important group of Canadian imports; and in each case the fall in the United Kingdom's share of the trade is balanced by a corresponding increase in the share held by the United States. For Canadian imports in total, the proportion supplied by the United Kingdom was only 10·3 per cent. in 1951, compared with an average of 18·3 per cent. for 1937/39. On the other hand, the proportion taken from the United States was 69 per cent. in 1951, against 61 per cent. in the earlier period. The declining proportion of Central and South American trade held by the United Kingdom—most serious in Argentina, Chile, Uruguay and Venezuela—is also a reflection of the increasing dominance of the United States in the trade of the American Continent.

Table IV

United Kingdom: Share of Import Trade of World Markets

Percentage of Total Imports taken from the United Kingdom

	1929	1938	1951
Australia	39·7	41·5	44·8
New Zealand	48·7	48·5	59·0
India, Burma and Pakistan	42·4	31·4	18·2
Malaya	16·5	18·4	16·6
Ceylon	21·1	20·6	21·9
South Africa	43·1	43·2	35·4
Canada	15·0	17·6	10·3
Ireland	78·1	50·5	46·6
Germany	6·4	5·2	3·4
Austria	2·8	4·4	11·7
Belgium	11·2	7·9	8·3
France	10·0	7·0	3·6
Italy	9·6	6·3	3·6
Holland	9·4	8·1	8·2
Switzerland	6·0	5·9	6·7
Spain	13·0	11·1	7·3
Denmark	14·7	34·6	25·7
Sweden	17·3	18·2	16·3
Norway	21·2	23·1	22·9
Finland	13·0	21·7	14·2
Estonia	10·1	17·9	n.a.
Latvia	8·4	19·3	n.a.
Lithuania	8·5	30·9	n.a.
U.S.S.R.	6·2	16·0	n.a.

	1929	1938	1951
Poland	8·5	11·4	8·2
Hungary	2·8	6·0	n.a.
Roumania	7·3	8·1	n.a.
Czechoslovakia	4·1	5·4	n.a.
Yugoslavia	5·6	8·7	11·3
Portugal	26·9	17·1	15·4
China	9·3	7·9	8·0
Dutch E. Indies	10·8	8·0	6·2
Japan	6·9	2·4	1·6
Philippines	4·1	2·1	1·4
Algeria	2·6	1·0	1·0
Egypt	21·2	23·0	16·2
United States	7·5	6·0	4·2
Argentina	17·6	18·3	*15·5
Brazil	19·2	10·4	10·2
Chile	17·7	10·5	7·3
Colombia	14·4	12·3	5·6
Costa Rica	12·7	7·2	5·8
Cuba	5·5	4·2	†1·4
Ecuador	19·1	7·7	6·3
Guatemala	9·7	5·9	3·1
Haiti	6·8	15·5	4·3
Mexico	6·7	4·1	1·9
Nicaragua	10·8	8·2	4·0
Peru	15·0	10·1	12·3
Uruguay	16·6	19·8	11·4
Venezuela	12·8	7·1	6·3

* 1948. From British export figures it is quite clear that the British share of the trade must have fallen considerably in 1950 and 1951.

† 1949.

IV

THE REVIVAL OF GERMAN AND JAPANESE COMPETITION

The revival of German and Japanese competition is of great significance for British export trade. The speed of German recovery, especially in the last two years, is truly remarkable. From a practically negligible level in 1946 her export trade rose rapidly, reaching a substantial volume in 1950 and 1951. Such estimates as are available indicate that the volume of exports from the Western Zone of Germany in 1951 was more than 20 per cent. greater than from the corresponding areas in 1936.

The pattern of German trade after this recovery is amazingly similar to that of pre-war. Comparison with pre-war is to some extent impaired, because the figures for current trade relate to the Western Zones only and those for pre-war are for the whole of Germany. On this basis, Europe now takes 68 per cent. of Germany's total exports, compared with 70 per cent. on average for the years 1936–38. The American Continent takes 18 per cent., compared with 15 per cent., a rise due mainly to the increased importance of the United States. Asia accounts for only 7 per cent., compared with 10 per cent. before the war. The most important European markets for German trade, and also those with which her trade has developed most rapidly in recent years, are Holland, Belgium, France, Sweden and Switzerland. The rapid expansion of German exports to these markets in 1951 may account to some extent for the decline in United Kingdom exports to Europe.[1]

The commodity character of revived German trade has also taken the traditional form of concentration on coal and coke, iron and steel, machinery, vehicles, chemicals and scientific instruments. Indeed, German export trade is now more nearly like the United Kingdom's than that of any other major exporting country. So long as these products are in short supply in world markets, the main effect on the United Kingdom of the re-entry of Germany into world trade is merely to lead to a redirection of British trade away from markets which Germany supplies. But when world demand for these goods is more nearly matched by the volume of supplies available, German competition will be felt much more acutely by United Kingdom exporters.

[1] United Kingdom exports to Europe increased by only 2 per cent. in value between 1950 and 1951; since United Kingdom export prices were rising substantially over this period, this implies an appreciable reduction in volume.

Japanese industry and foreign trade is taking longer to recover than that of Germany. Although Japan's exports have been increasing rapidly in the last three years, they were in 1951 still only a third by volume of the pre-war level. But because of the composition of Japanese exports, the force of Japanese competition has already been closely felt by United Kingdom exporters. With the continued steeply downwards trend in markets for raw silk[1], Japan now depends even more heavily than pre-war on exports of textiles (now over 40 per cent. of the total) and on the newer lines of trade in metal manufactures which she was beginning to develop in the late 1930's. Textile manufactures, clothing, metals and engineering products together now account for over 80 per cent. of Japan's total exports.

Japanese exports of cotton piece goods in 1951 were less than half pre-war in quantity, yet Japan has recaptured her place as the world's largest exporter in this field. Her trade has so far been much more concentrated on a few countries—British Africa, Malaya, Pakistan, Australia, Siam and Indonesia are the most important—some of which are also major markets for British cotton goods. Her trade is still negligible with some of her chief pre-war markets, such as China, French Morocco, the Middle East and South America.

The most significant feature of the distribution of Japan's export trade by countries is the substantial decline in the Chinese market. Before the war, shipments to China, Kwangtung, Manchuria and Hong-Kong accounted for just over 40 per cent. of Japan's total exports; in 1951 these markets took less than 10 per cent. of the whole. This contraction in the Chinese market for Japanese goods, resulting largely from the political situation, makes other markets of the world of much greater importance. Japanese competition in these markets is therefore likely to return to pre-war severity even with a much reduced total volume of exports.

V

BRITISH EXPORT PRICES

United Kingdom exports have increased substantially in volume since the end of the war, and are now much higher than before the war. Yet balance-of-payments crises have recurred with almost monotonous frequency. The reasons for the persistence of this problem, and the relative importance of

[1] Exports of raw silk were only 3 per cent. of the much reduced total in 1951, compared with 14 per cent. of the larger 1938 total.

the various contributory factors—inflation at home, the loss of overseas income, the special difficulty of earning dollars, the adverse movement of the terms of trade[1]—are subjects of considerable controversy. All parties to the controversy nevertheless agree that the adverse movement of the terms of trade has aggravated what would in any case have been a difficult problem.[2] But it has often been argued that this adverse movement is, to some extent at least, our own fault: while we could not avoid paying substantially higher prices for our imports, the argument runs, we need not have sold our exports so cheaply.

According to this view, a rather higher level of prices for exports during most of the post-war period would not have had serious damaging effects on the volume of our export sales. This implies that on the whole it has been availability of goods rather than the competitiveness of our prices which has been the main factor limiting the volume of our exports since the end of the war. On this reasoning the devaluation of sterling in 1949 by so large an amount was a mistake, and the appreciation of sterling at any time during the last eighteen months would have had a beneficial effect on our overseas payments position.

The idea that the appreciation of the pound—or, what would amount to the same thing, raising our export prices without appreciation—could help us when we are in balance-of-payments difficulties is so novel and apparently contradictory that it has received far less attention than it deserves[3]. It is impossible to demonstrate conclusively from statistical evidence whether we could have obtained higher prices for our exports during the last few years, yet an analysis of the figures that are available does throw some light on this argument.

A few words of warning about the nature of the figures available are necessary before turning to discuss them. All the published statistics about export prices refer, not to actual prices quoted, but to the "average values" of goods exported as recorded in the Trade and Navigation Accounts. Changes in these average values may reflect not only changes in prices but also changes in quality; and where figures are calculated for total trade or groups of commodities the changing composition

[1] The relationship between the movement of the prices we pay for our imports and the prices we receive for our exports; arithmetically, the change in import prices divided by the change in export prices, with the figures for some chosen base period equated to 100.

[2] It is, of course, not always true that an adverse movement of the terms of trade and a deterioration in the balance of payments go together.

[3] The advisability of appreciating the pound raises other questions which are not relevant to the issues being discussed in this article.

of trade may affect the result. The figures of average values, moreover, since they are based on the trade returns, relate to the period when the goods actually leave the United Kingdom; they will, therefore, tend to lag behind the movement of actual prices being quoted for current new business at the time. Further, in comparing the movement of import and export prices on this "average value" basis, it must be remembered that while the trade returns record exports f.o.b., imports are recorded c.i.f. Hence the movement of import "prices" reflects changes in shipping freights and other import costs, as well as the price paid to the seller overseas. It is obvious that figures on this basis cannot lead to more than qualified and tentative conclusions.[1]

These figures of "average value" of imports and exports reveal quite clearly the startling nature of the adverse movement of the terms of trade that has taken place during the last fifteen years. In the first quarter of 1952, import prices were 72 per cent. above 1947 and about $4\frac{1}{2}$ times pre-war (1938), while export prices had increased by only 45 per cent. compared with 1947 and were less than $3\frac{1}{2}$ times pre-war. Thus the "terms of trade" in 1952 had moved adversely by 19 per cent. compared with 1947 and by 37 per cent. compared with 1938.

But this comparison of the movement of *total* import and export prices—the usual basis on which the terms of trade are measured—conceals some of the significant changes that have been taking place. The generally held view is that the adverse movement is due to the rapidly rising prices for both the food and raw materials which we buy abroad, compared with the prices of the manufactured goods which we sell. In reality, practically the whole of the adverse movement since 1947 is due to the relative rise of raw material prices, for since that year import prices of food have remained fairly stable—not, admittedly, in actual money terms but in relation to the prices of exports of manufactured goods. This can be seen quite clearly if one calculates, as in Table V overleaf, two subsidiary sets of terms of trade indices, one comparing the movement of food import prices with those of manufactures exported and the second comparing raw material import prices with those of manufactures.

[1] There is the further point that, to make comparisons with pre-war and over the whole post-war period, one has to link together sets of index numbers which have different bases of weighting. There are in addition numerous technical statistical difficulties in compiling these indices and one should be most cautious in drawing any deductions from them.

The difference between the movement of these two indices emerges quite clearly. Between 1938 and 1946, the terms of trade both for food and for raw materials moved against us by 13 per cent. Since 1946, however, the terms of trade for food have remained practically unchanged, while the terms of trade for raw materials have moved further against us, especially in 1950 and 1951. In the latter year, raw materials were twice as dear by comparison with finished manufactures as they had been in 1938.

Table V

United Kingdom: Import and Export Prices and the Terms of Trade

1938 = 100

	Prices (average values)					Terms of Trade		
	Imports			Exports				
	Total (1)	Food, Drink and Tobacco (2)	Raw Materials (3)	Total (4)	Manufactures (5)	All Imports and all Exports $\frac{(1)}{(4)}$	Food Imports and Manufactures Exports $\frac{(2)}{(5)}$	Raw Materials Imports and Mnfrs. Exports $\frac{(3)}{(5)}$
1938	100	100	100	100	100	100	100	100
1946	210	221	219	196	196	108	113	113
1947	258	256	278	223	222	116	115	125
1948	285	277	328	242	242	117	114	135
1949	294	284	334	251	249	116	113	135
1950	330	305	411	263	260	124	117	159
1951	431	351	600	303	300	141	116	200
1st Qr. 1952	444	371	592	323	322	137	115	184

It is thus clear that it is the relative movement of raw material import prices and of manufactured goods export prices which accounts for most of the adverse shift in the terms of trade, especially in the last two years. Hence it is of interest to examine more closely what has happened to the different groups within each of these categories. The wide diversity of movement is remarkable.

Consider first the movement of raw material prices between 1938 and 1951. At one extreme, prices for iron ore and scrap had little more than trebled; at the other extreme cotton and wool were standing at nearly ten times their pre-war level. On the side of manufactured exports, the rise in prices also covered a wide range. At the lower end of the scale, prices for chemicals

were less than two and a half times the pre-war figure; by contrast, prices for cotton yarns and manufactures were nearly six times as high as in 1938. It is noticeable that it is those export products which have a relatively low raw material content that have risen least in price. In this category one would place such groups as machinery, vehicles, electrical goods and chemicals. It is also noteworthy that these same products, particularly machinery and electrical goods, have been in acutely short supply in most of the markets of the world throughout the post-war period. There is apparently some evidence here that export prices of many British products have been kept at an unnecessarily low level.

Table VI
United Kingdom: Average Value of Main Raw Material Imports

1938 = 100

	1947	1949	1950	1951	1st Qr. 1952
Total	**278**	**334**	**411**	**600**	**592**
Raw cotton	305	462	601	967	802
Raw wool	197	324	538	971	577
Iron ore and scrap	174	190	228	308	423
Non-ferrous metalliferous ores and scrap	200	240	316	458	474
Seeds, nuts, oils, etc.	396	467	479	618	693
Paper making materials	316	307	338	762	951
Wood and timber	315	324	328	495	551
Hides and skins	300	314	360	540	453
Rubber	187	174	344	651	574

Table VII
United Kingdom: Average Value of Main Exports of Manufactures

1938 = 100

	1947	1949	1950	1951	1st Qr. 1952
Total	**223**	**251**	**263**	**303**	**323**
Iron and steel and mnfrs. thereof	189	223	221	255	295
Non-ferrous metal manufactures	189	203	268	335	367
Machinery	197	232	236	256	276
Vehicles	204	216	224	257	277
Electrical goods and appliances	222	252	260	297	324
Cutlery, hardware, etc.	214	201	238	261	278
Cotton yarns and manufactures..	362	440	471	594	630
Woollen yarns and manufactures	244	296	342	486	471
Apparel	273	305	328	393	401
Chemicals, drugs and dyes ..	216	243	235	240	276
Oils, fats and resins	215	254	254	271	295
Paper, cardboard, etc.	222	260	220	326	384
Leather and manufactures ..	299	286	338	422	389

Two things have to be explained. The first is the fact that raw materials have risen so much more than manufactures in general. The second is the diversity of the price movements between different groups of manufactured goods. Only one plausible explanation of these phenomena suggests itself. It is the traditional one, that prices for primary products are much more flexible than those of manufactured goods, owing to differences in market organization. An increase in the demand for raw materials, at a time when supplies are limited, will reflect itself in an immediate and very steep rise in prices. For raw materials, in other words, it is the level of demand rather than the level of costs which in the short run governs the movement of prices. In the case of manufactured goods, the position is reversed. There, costs play the most important rôle and prices tend to move upwards only as raw material costs and wage levels increase.

This difference between the behaviour of raw material prices and the price of manufactures in general would in turn help to explain why export prices for cotton goods have risen so much more steeply than those of machinery; for cotton goods have a much higher raw material content than machinery, while in addition the price of raw cotton has risen much more than the price of steel. Certainly, the fact that export prices for steel and machinery have risen so much less than those of many other groups of exports could not be explained in terms of the pressure of demand, since steel exports have been in such short supply that they have actually been rationed throughout most of the post-war period and could only be obtained from the United Kingdom on long delivery terms.

It may be tempting to jump to the conclusion that an appreciation of sterling would have been a beneficial remedy for this situation.[1] There are, however, various other considerations to be taken into account. First, an appreciation of sterling would affect prices of all British exports; and it could hardly be claimed that the evidence shows that higher prices could have been obtained for *all* types of British goods. Higher prices might have had little effect on the volume of sales of such items as steel and machinery, but they would have had serious consequences for our deteriorating competitive position in

[1] Conditions have changed a good deal during the last six months. Even if it were accepted that appreciation might have been beneficial 12 or 18 months ago, this would not imply that such an appreciation would be beneficial now. In any case, although raw material prices are now falling, the prices of some of our exports—particularly engineering products—continue to rise and may rise even further if some of the current wage demands are conceded.

cotton goods and other textiles. Secondly, one must enquire into the movement of export prices in those other countries which are also major exporters of manufactures. If we should find that their export prices also have risen little by comparison with those of raw materials, it is clear that the risks that would be run by putting up British prices would be much greater.

Some evidence does exist about the relative movement in export prices in Britain and in other countries during the last few years. To interpret this evidence, however, leads one on to very treacherous ground. There is a great difference in the composition of the export trade of the chief manufacturing countries, and a comparison based on changes in the average value of total trade (the usual basis on which such comparisons are in fact made) can be most misleading. Even where comparisons can be made for exports of manufactures alone—and this can be done only for the United States, Germany and the United Kingdom—any conclusion must be hedged round with qualifications. The only satisfactory basis of comparison would be actual price quotations for identical products, but such information is practically unobtainable. Yet even so the figures in Table VIII overleaf are of substantial interest.

The most remarkable feature of these figures is the relative stability of United States export prices for manufactured goods.[1] There was a slight fall in prices between the beginning of 1949 and the middle of 1950, and thereafter a gradual rise to the end of 1951. But by the end of last year prices were hardly higher than at the beginning of 1949. Over the same period the prices of British manufactured exports rose by about 36 per cent. These are, of course, sterling prices. If one takes the reduction in the dollar equivalent of sterling prices due to the devaluation in September, 1949, as 30 per cent., the rise in British sterling prices has just about wiped out any advantage vis-à-vis the United States that the United Kingdom obtained through devaluation.

Clearly, if British export prices for manufactures are inflexible, American prices are far more inflexible! German prices for finished goods have moved very similarly to those of the United Kingdom. By contrast, Belgium's export price index fell by 16 per cent. between the beginning of 1949 and the middle of 1950, and then rose by 51 per cent. by the end of 1951[2]. Unfortunately, this figure relates to the whole of

[1] This seems the appropriate index to compare with the British index covering goods "wholly or mainly manufactured."

[2] If account is taken of the appreciation of the belga in relation to sterling in September 1949, the rise in Belgian prices compared with British prices is even more striking.

Belgium's export trade ; but there is little doubt that Belgium's readiness to raise the price of steel, which is a substantial element in her exports, accounts at least to some extent for this movement.

It is not easy to draw any firm conclusions from all this evidence, particularly if one remembers the shaky basis on which the figures are compiled. It might be argued that in the light of the events of the last two years it was a mistake to have devalued the pound by such a substantial margin in 1949. But at the time no-one could have been expected to

TABLE VIII

United Kingdom, United States and Germany :

Price Movement (Average Values) of Exports of Manufactures

In local currencies.

	United Kingdom Articles wholly or mainly manufactured Sept. 1949 = 100	United States Finished Manufactures Sept. 1949 = 100	Germany Finished Goods 1950 = 100
1949			
January ..	101	107	100
April ..	101	104	100
July ..	100	100	100
October ..	100	97	100
1950			
January ..	102	100	99
April ..	103	96	100
July ..	105	97	99
August ..	105	96	98
September ..	105	99	98
October ..	107	101	99
November ..	110	102	101
December ..	111	106	101
1951			
January ..	112	106	105
February ..	115	107	108
March ..	119	109	113
April ..	121	111	115
May ..	124	111	120
June ..	126	111	122
July ..	129	110	125
August ..	131	111	126
September ..	132	109	128
October ..	134	109	127
November ..	135	109	130
December ..	135	111	129
1952			
January ..	134	n.a.	128
February ..	135	n.a.	131
March ..	136	n.a.	n.a.
April ..	136	n.a.	n.a.

foresee the Korean crisis and the boom that it initiated. Whether an appreciation of sterling in the second half of 1950 or early in 1951 would have helped the British overseas position in the long run is highly debatable. There is some evidence that for many items of exports (particularly those based on steel, the home price of which was controlled at a relatively low level throughout this period) the United Kingdom could have commanded higher export prices for a time without damaging the volume of exports. For although American prices were not rising, U.S. competition might not have mattered so much during this period, since supplies of metal goods from the United States were also available only in limited quantities. Yet there are obvious longer-run risks in our putting up prices while United States prices remain stable.

The obviously desirable remedy would be to have more flexible export prices, prices moving more promptly and more sharply in response to changes in demand and in competition from other suppliers. But this is as difficult to achieve, for reasons which would take us beyond this article, as it is desirable. It must be emphasized that it would be no use having flexibility in an upward direction without flexibility downwards as well. For if British prices should rise as the force of demand increased, and then stay at the higher level when demand slackened, the effect on the volume of our exports would be catastrophic.

Ely Devons.

University of Manchester,
June, 1952.

Statistics: Explanatory Notes

Industrial Production.—It appears that the United States now produces more than half of the world total of industrial output, excluding Russia. The share of the United Kingdom, by contrast, declined from about one-third of the whole in 1870 to around 10 per cent. in the nineteen-twenties, but has since remained very stable; in other words, production in this country has expanded at about the same rate as in the rest of the world. It will be seen that before the war German production was running higher than our own, but was far from having regained that position in 1950. From the nature of the data, of course, the figures cannot be regarded as precise estimates, but merely as an indication of trends.

Within the United Kingdom, the increased importance of the metal, engineering and vehicles industries, on the one hand, and the relative decline in textiles and coal-mining, on the other hand, are brought out by the second chart on page 48.

Income Tax.—From the first chart on page 49 it will be seen that while in the current financial year the effective rate of tax paid on incomes up to about £1,000 (married man with two children, all income earned) is somewhat less than in 1938–39, there has not been an equivalent easing of the tax burden on the higher income brackets. Thus, a man earning £800 a year in 1952–53 pays 4½d. in the £ less than in 1938–39, against an *increase* of 1/2½d. on an income of £2,000.

Bank Advances.—Loans to all manufacturing industries combined have risen appreciably over the past year and in May accounted for over a quarter of the total. Personal and professional advances, in contrast, have shown a modest contraction in each successive return since last August. The relative decline in this category, compared with the movements in advances to other groups, has been even more marked. In May this year personal advances had declined to 21 per cent. of the total, against 23 per cent. a year ago and nearly 30 per cent. in 1946.

Security Yields.—The general upward trend in yields since last autumn, associated with the rise in Bank Rate from 2 to 4 per cent., is brought out by the chart on page 51.

European Payments Union.—As will be seen from the chart on page 52, there has been a sharp contraction in our monthly deficit with E.P.U. from the large figures of last autumn. Even so, the sterling area had by May entirely exhausted its credit facilities with the Union, so that any further deficits will have to be settled entirely in gold or dollars. Belgium, in contrast, has run a surplus each month over almost the entire period during which E.P.U. has functioned, while the German position has radically improved since early last year.

The liquid resources of the Union suffered a substantial decline during 1951 but have since shown some recovery, due largely to the heavy gold payments by the U.K.

Exchange Rates.—The two charts on page 53 for the U.S. dollar and the French franc show the movements in the market rates for these two currencies, in terms of sterling, since the reopening of the London foreign exchange market last December.

Textiles.—The decline in demand for textiles, both at home and abroad, that developed during the second half of 1951 is brought out by the charts on page 54. As will be seen, half of our textile exports in 1951 was taken by Commonwealth countries (other than Canada) but with the recent restriction of imports in certain of these, notably Australia, our sales this year are likely to suffer a further set-back. At home, sales have fallen sharply—in the first quarter of the year the volume of clothing purchases made by the public was 26 per cent. less than in the same months of 1951.

The effect of this falling off in demand has been a check to production, resulting in a steep rise in unemployment in the textile and clothing industries (page 55). Unemployment has been particularly marked amongst women—in May, of all women registered as unemployed in Great Britain no less than 47 per cent. were in textiles and clothing. Taken together, unemployed workers in these two industries in March represented 7 per cent. of their total labour force, against less than 1 per cent. a year earlier. For all other industries combined the unemployment rate has shown a moderate increase in recent months, to about the same level as the beginning of 1950.

Price Trends.—Since the middle of last year the " terms of trade " have moved slightly in our favour—import prices have tended to fall while export prices have shown a modest increase. Wholesale prices, after rising steadily in this country during 1951, have lately levelled off, in contrast to the position in the U.S., where there has been little movement for well over a year. A similar divergence has been shown by the trend of retail prices: a marked rise in the U.K. in 1951, against only a small increase in the U.S.

Distribution of Trade.—The first two charts on page 57 bring out the increased importance of the sterling area in our external trade, compared with the pre-war position. This is especially marked as regards exports—in 1951 nearly half our total sales abroad was in sterling countries, against little over 40 per cent. in 1938. The share of the U.S. and Canada in our export trade, in contrast, has in recent years been about the same as pre-war.

The charts on U.S. trade show the sharp fall in the proportion of American imports from the sterling area. This has meant an appreciable worsening in our balance of trade with the U.S., particularly for sterling countries other than the U.K.

Coal and Steel.—From the first two charts on page 58 it will be noted that while the trend of coal production has been upwards over the last two years, that for steel output has tended to decline since the summer of 1950. If increased supplies of raw materials are forthcoming, however, in particular iron ore and coke, it is hoped that steel production in the latter part of this year should rise above the 1951 level. This disparate experience has been reflected in stock movements—stocks of coal at the end of May were over 4 million tons higher than at the same date last year, in contrast to an appreciable decline in steel reserves.

WHITHER EUROPE—UNION OR PARTNERSHIP?

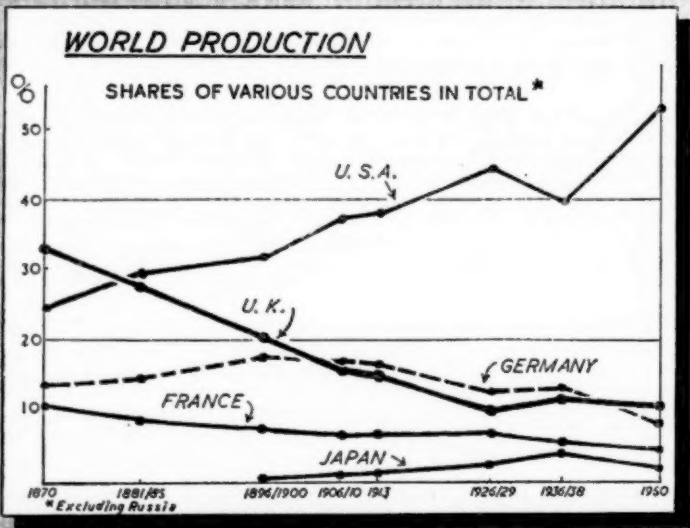
By M. J. Bonn

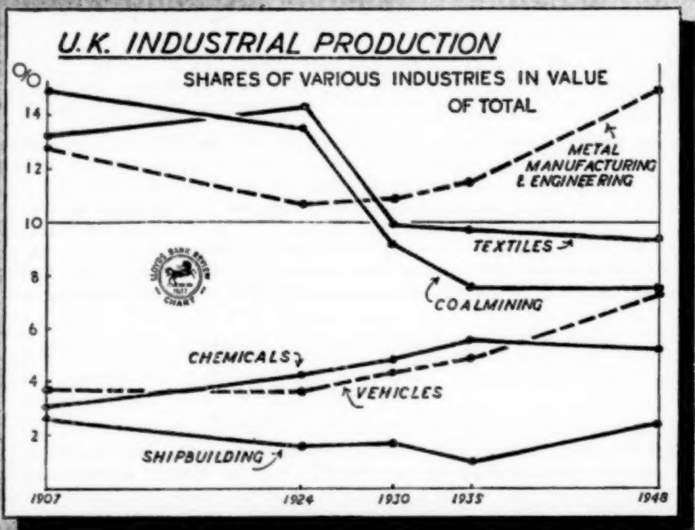
(Cohen & West Ltd. Price 15s.)

In this timely book on international affairs, Dr. Bonn surveys realistically, and with many apt parallels from the past, the efforts of the Western European countries since the end of the war to come together with American backing to put their defences on a firm basis. Viewing the problem against its historical background, he argues strongly against proposals for a federal union in Europe and advocates instead a system of partnerships, joint institutions and limited working arrangements.

J. R. W.

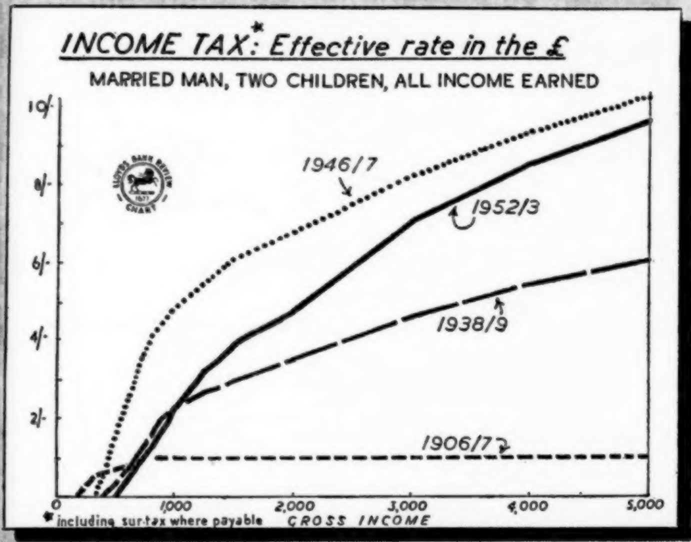
INDUSTRIAL PRODUCTION

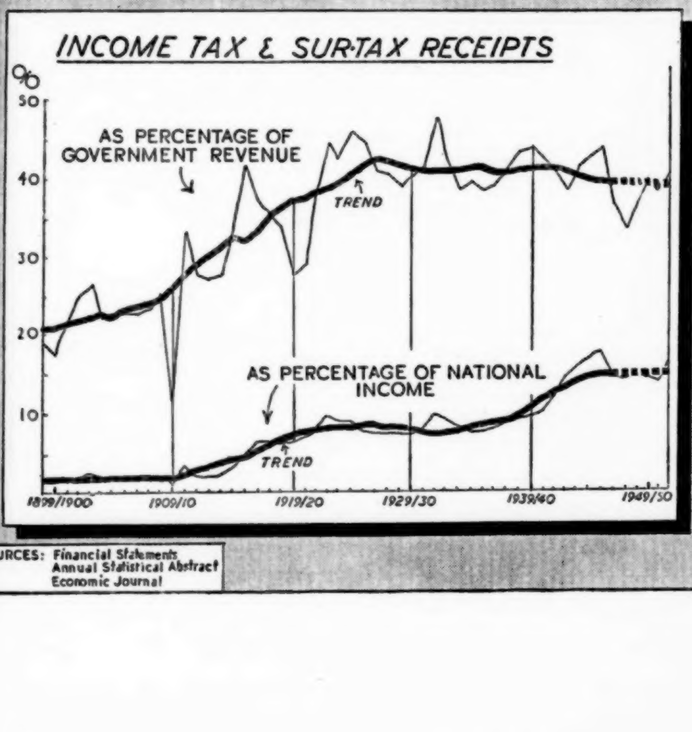




SOURCES Industrialisation & Foreign Trade (League of Nations)
U.N. Publications
U.K. Census of Production returns

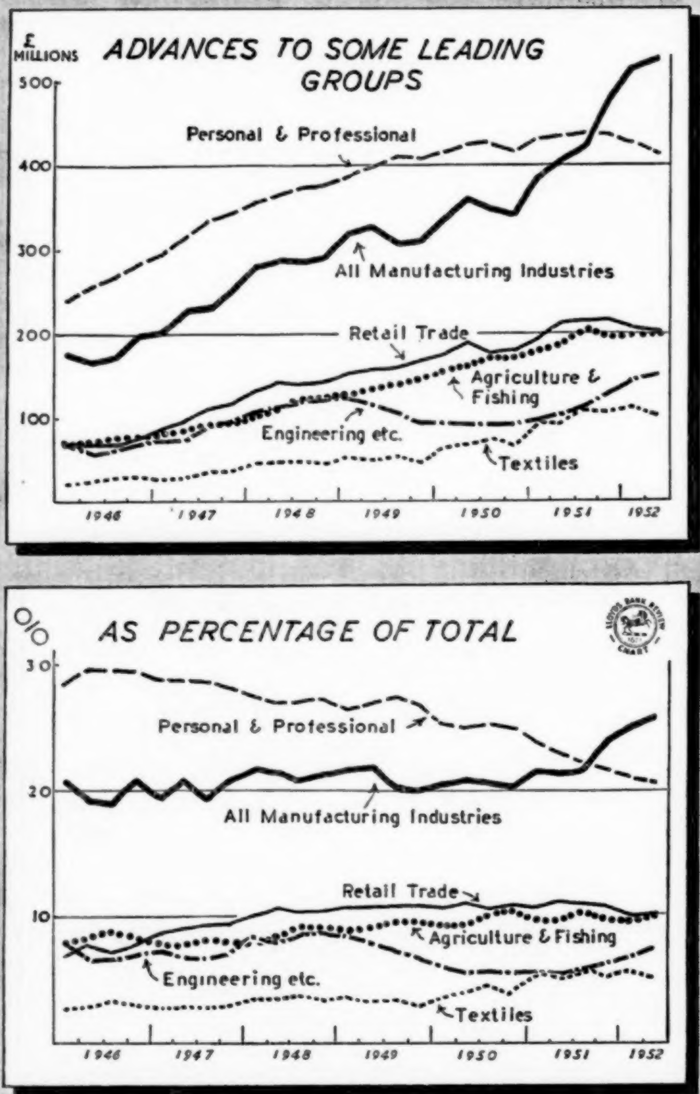
INCOME TAX



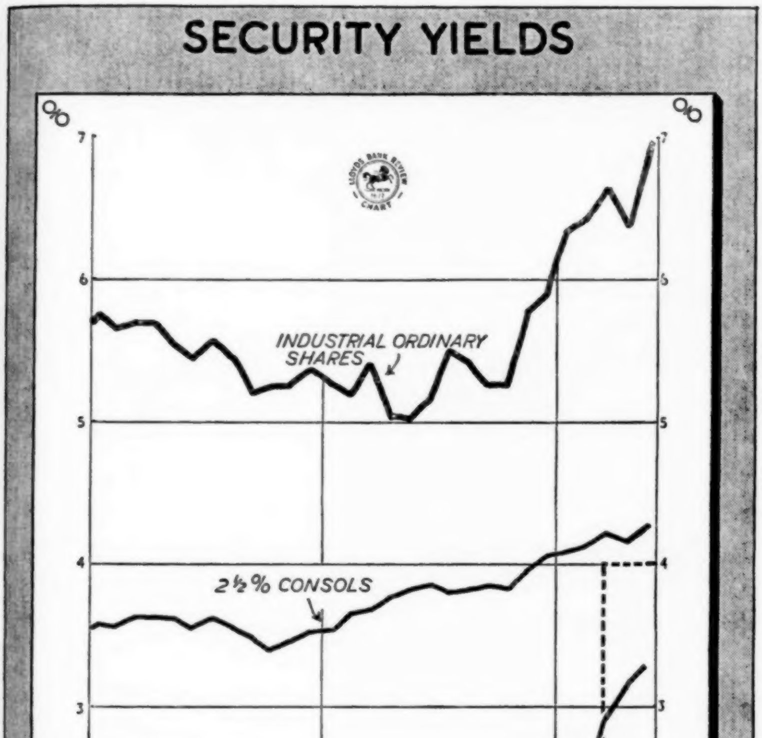


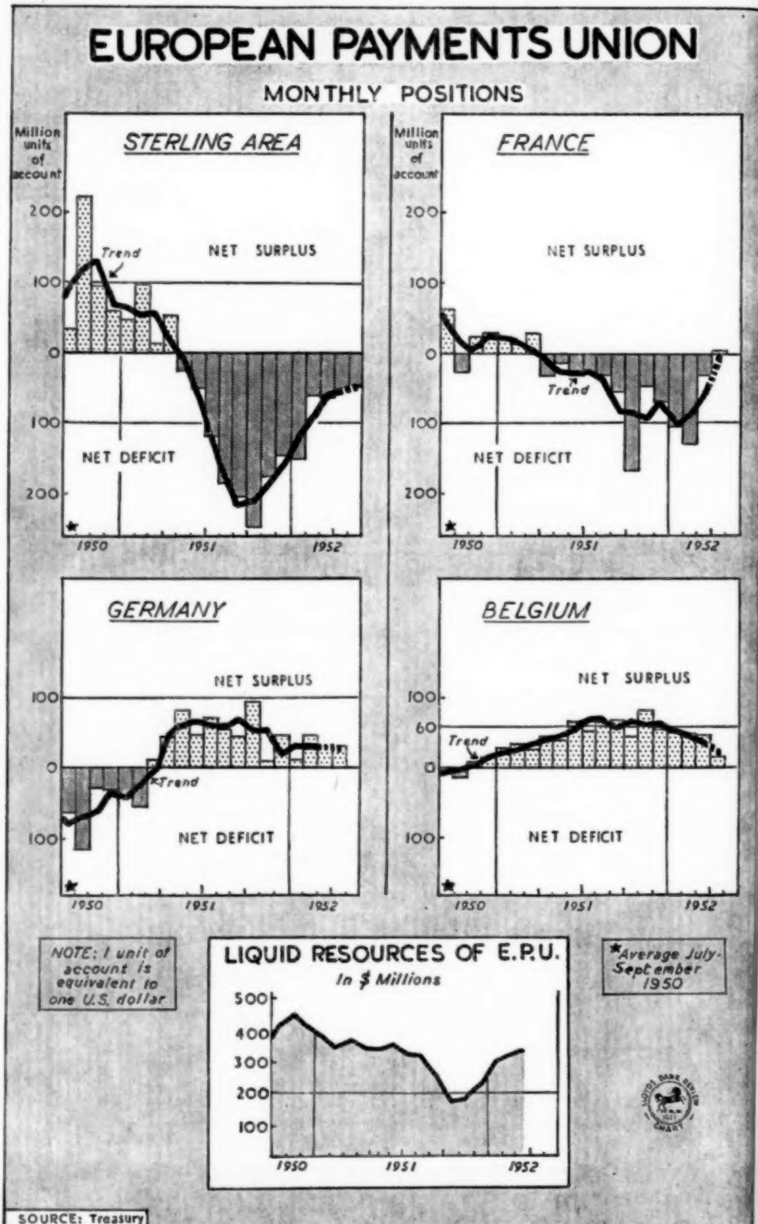
SOURCES: Financial Statements
Annual Statistical Abstract
Economic Journal

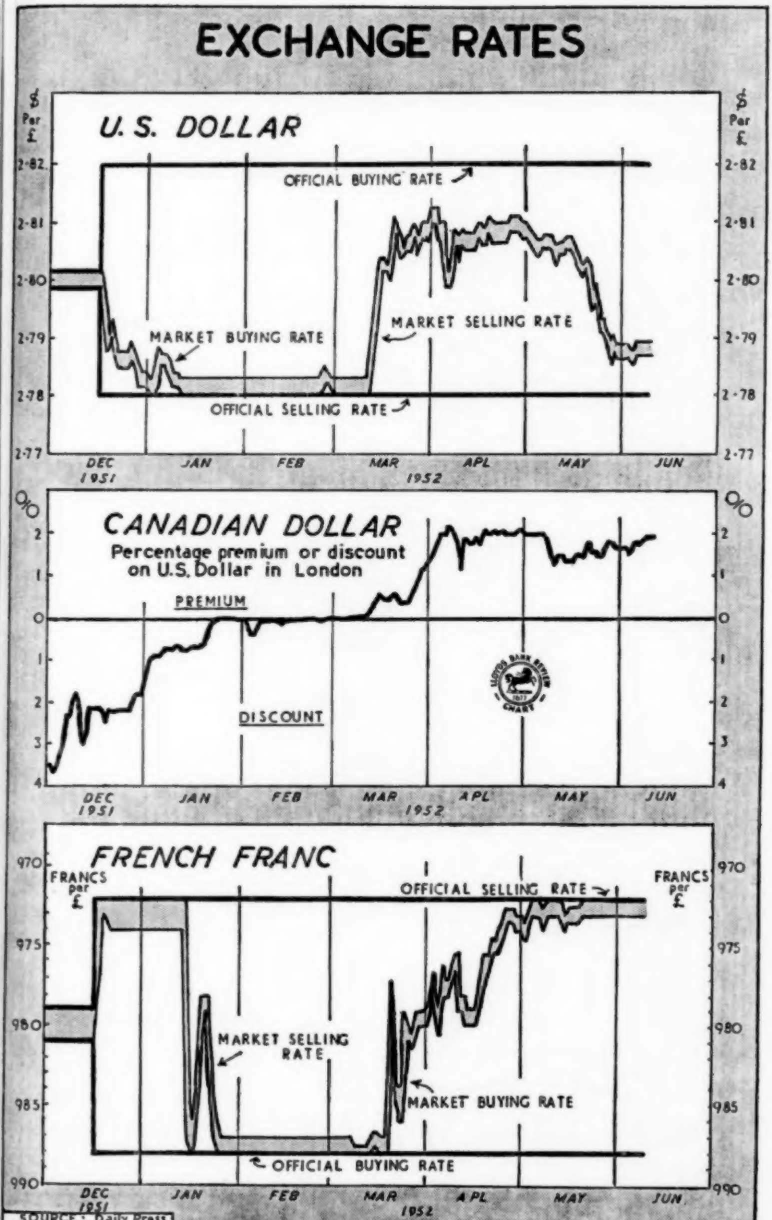
BANK ADVANCES



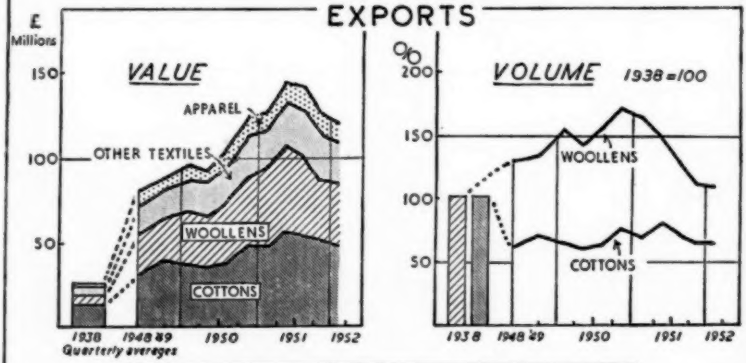
SOURCE: British Bankers' Association

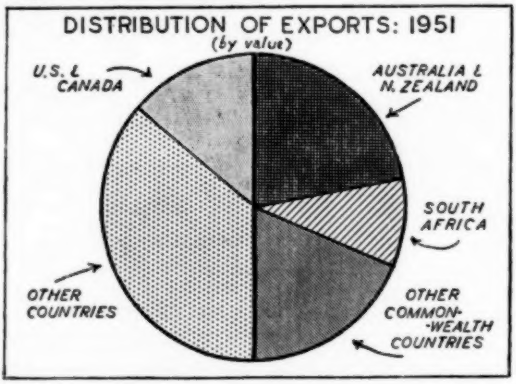

SECURITY YIELDS
%
%
INDUSTRIAL ORDINARY SHARES
2½% CONSOLS
BANK RATE
SHORT-DATED GILT-EDGED (2¼% Exchequer Stock 1955)
TREASURY BILL RATE
1950
1951
1952
SOURCES: Monthly Digest of Statistics Daily Press

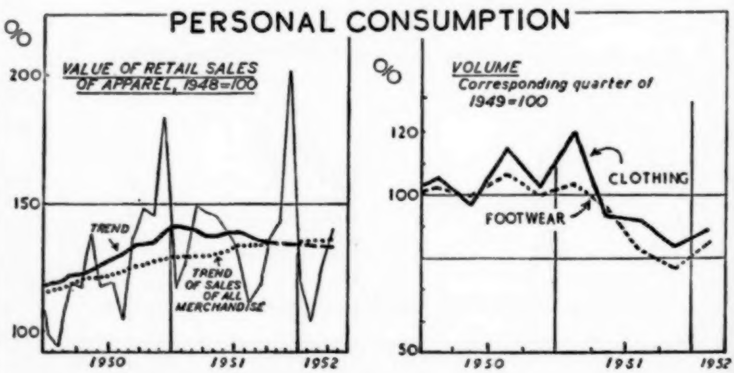

EUROPEAN PAYMENTS UNION
MONTHLY POSITIONS
Million units of account
STERLING AREA
FRANCE
GERMANY
BELGIUM
NET SURPLUS
NET DEFICIT
Trend
200
100
60
0
1950
1951
1952
NOTE: 1 unit of account is equivalent to one U.S. dollar
LIQUID RESOURCES OF E.P.U.
In $ Millions
500
400
300
*Average July-September 1950
SOURCE: Treasury


EXCHANGE RATES
U. S. DOLLAR
$ Per £
2·82
2·81
2·80
2·79
2·78
2·77
OFFICIAL BUYING RATE
MARKET SELLING RATE
MARKET BUYING RATE
OFFICIAL SELLING RATE
DEC 1951
JAN
FEB
MAR
1952
APL
MAY
JUN
CANADIAN DOLLAR
Percentage premium or discount on U.S. Dollar in London
%
PREMIUM
DISCOUNT
2
1
0
1
2
3
4
FRENCH FRANC
FRANCS per £
970
975
980
985
990
OFFICIAL SELLING RATE
MARKET SELLING RATE
MARKET BUYING RATE
OFFICIAL BUYING RATE
SOURCE: Daily Press

TEXTILES

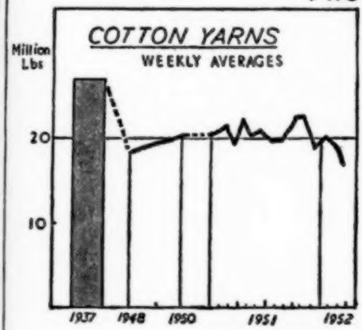

EXPORTS
£ Millions
VALUE
APPAREL
OTHER TEXTILES
WOOLLENS
COTTONS
150
100
50
1938
1948 '49
1950
1951
1952
Quarterly averages
VOLUME 1938=100
%
200
150
100
50
WOOLLENS
COTTONS
1938
1948 '49
1950
1951
1952

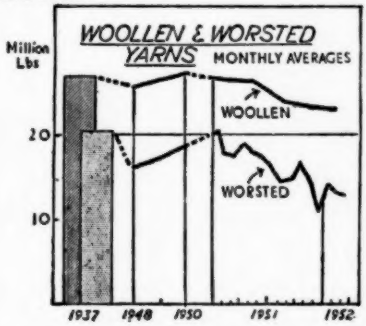

DISTRIBUTION OF EXPORTS: 1951
(by value)
U.S. & CANADA
AUSTRALIA & N. ZEALAND
SOUTH AFRICA
OTHER COMMON-WEALTH COUNTRIES
OTHER COUNTRIES

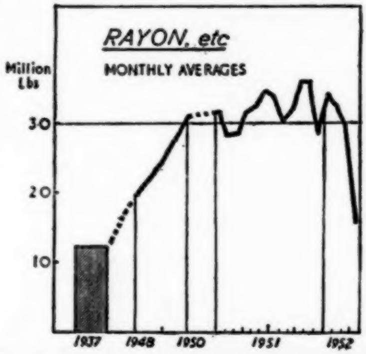

PERSONAL CONSUMPTION
%
VALUE OF RETAIL SALES OF APPAREL, 1948=100
200
150
100
TREND
TREND OF SALES OF ALL MERCHANDISE
1950
1951
1952
%
VOLUME
Corresponding quarter of 1949=100
120
100
50
CLOTHING
FOOTWEAR
1950
1951
1952

TEXTILES

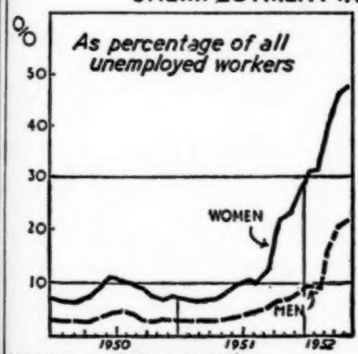
PRODUCTION

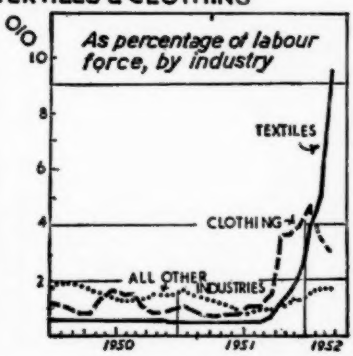






UNEMPLOYMENT IN TEXTILES & CLOTHING

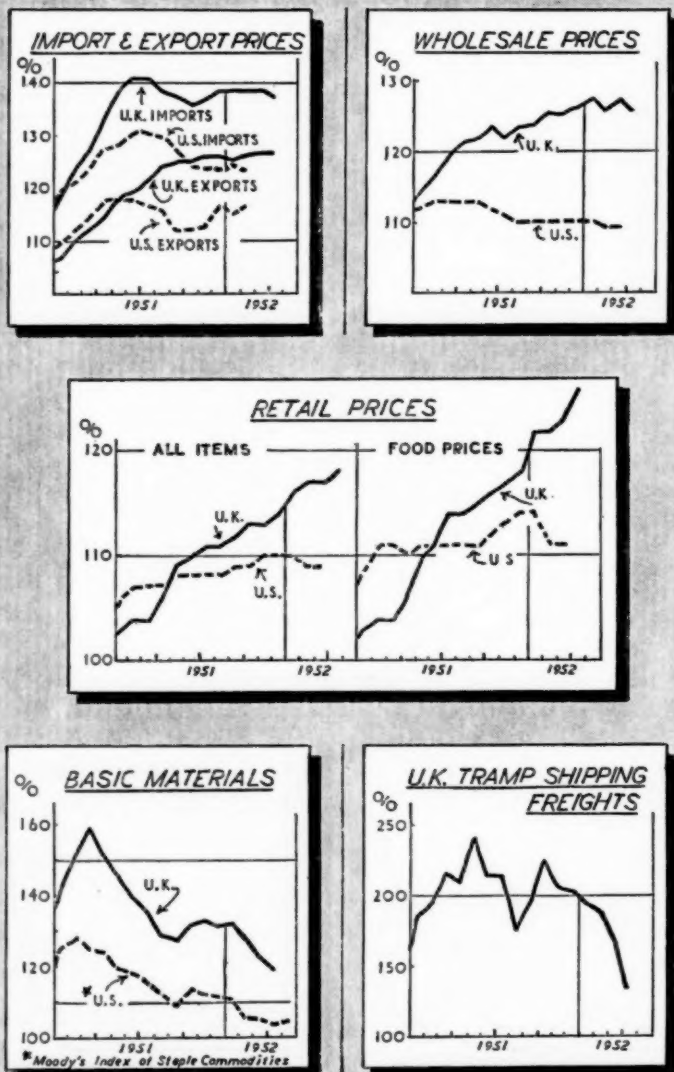




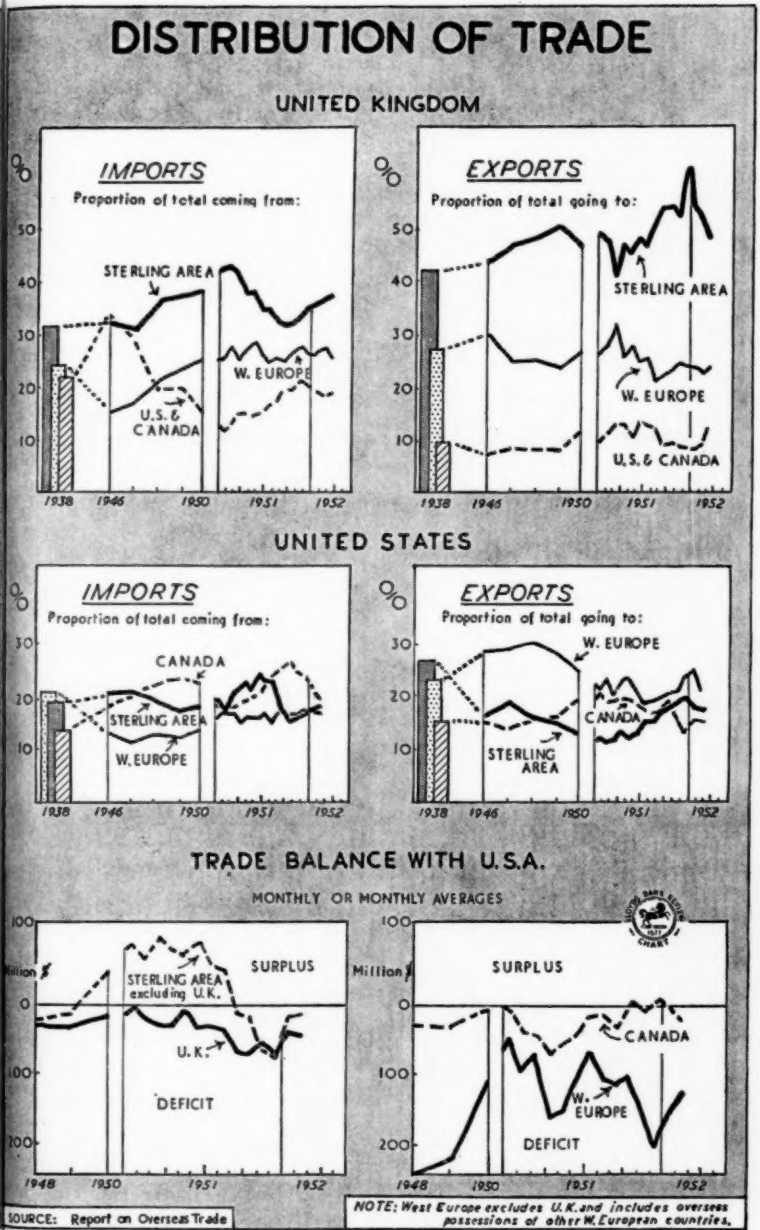
SOURCES: Monthly Digest of Statistics
Ministry of Labour Gazette

PRICE TRENDS

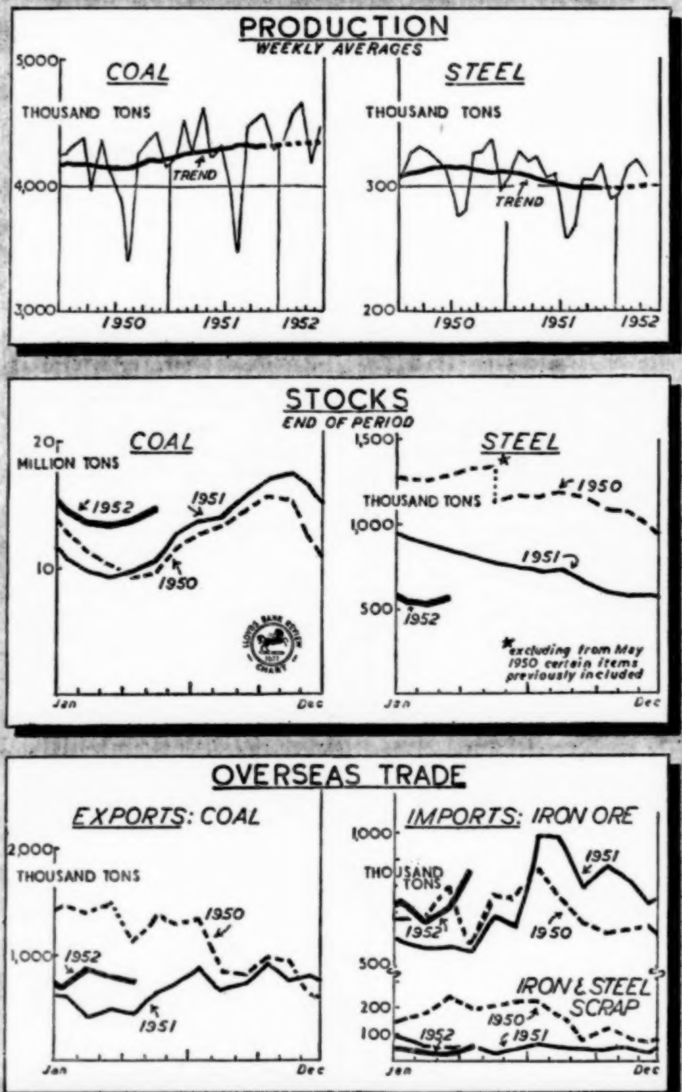
1950 = 100



SOURCES: Monthly Digest of Statistics
Survey of Current Business


DISTRIBUTION OF TRADE
UNITED KINGDOM
IMPORTS
Proportion of total coming from:
STERLING AREA
W. EUROPE
U.S. & CANADA
EXPORTS
Proportion of total going to:
STERLING AREA
W. EUROPE
U.S. & CANADA
UNITED STATES
IMPORTS
Proportion of total coming from:
CANADA
STERLING AREA
W. EUROPE
EXPORTS
Proportion of total going to:
W. EUROPE
CANADA
STERLING AREA
TRADE BALANCE WITH U.S.A.
MONTHLY OR MONTHLY AVERAGES
Million $
SURPLUS
STERLING AREA excluding U.K.
U.K.
DEFICIT
SURPLUS
CANADA
W. EUROPE
DEFICIT
SOURCE: Report on Overseas Trade
NOTE: West Europe excludes U.K. and includes overseas possessions of other W. European countries.

COAL & STEEL



SOURCE: Monthly Digest of Statistics